ACADEMIC PAPERS

System of Instruments to Combat VAT Fraud in the Czech Republic

Ondřej Málek

Wolters Kluwer

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A C A D E M I C   P A P E R S

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In the academic sphere, he teaches tax law and participates in research projects in the field of financial law. He is the author of numerous scholarly publications. In addition, he serves as a member of the Remonstrance Commission of the Ministry of Finance of the Czech Republic. He is a member of the Chamber of Tax Advisers of the Czech Republic, CFE Tax Advisers Europe, International Fiscal Association, the Czech Christian Academy and the Union of Czech Lawyers.

LIST OF ABBREVIATIONS[1]

Act on Customs Administration
Act No. 17/2021 Coll., on the Customs Administration of the Czech Republic
Act on Financial Administration
Act No. 456/2011 Coll., on the Financial Administration of the Czech Republic
Act on International Cooperation
Act No. 164/2013 Coll., on International Cooperation in Tax Administration and on the Amendment of Certain Related Acts
AML Act
Act No. 253/2008 Coll., on Certain Measures Against Money Laundering and Terrorist Financing
Civil Code
Act No. 89/2012 Coll, Civil Code
Criminal Code
Act No. 40/2009 Coll., Criminal Code
Criminal Procedure Code
Act No. 141/1961 Coll., Criminal Procedure Code
Customs Administration
Customs Administration of the Czech Republic under the Act on Customs Administration
Excise Act
Act No. 353/2003 Coll., on Excise Duties
Financial Administration
Financial Administration of the Czech Republic under the Act on the Financial Administration of the Czech Republic
Tax Procedure Code
Act No. 280/2009 Coll., the Tax Procedure Code
VAT
Value Added Tax
VAT Act
Act No. 235/2004 Coll., on Value Added Tax
VAT Directive
Council Directive 2006/112/EC of 28 November 2006 on the common system of value added tax

[1] Unless stated otherwise, all legislation cited in the text is referred to as amended.

1 INTRODUCTION

Value-added tax may be regarded as the basis of indirect taxation not only in Czechia but across the entire EU. Since 1 January 1987 it has been the only general indirect tax in all Member States,[1] and it provides tax revenue not only for individual Member States but also for the EU.[2] However, VAT is also one of the central pillars of the Czech tax system from the perspective of public revenue.[3] This is evident from Czech tax-collection data, where VAT ranks among the most significant taxes in both absolute and relative terms. It remains first even when all forms of personal and corporate income tax are combined.

Table 1: Overview of tax collection in Czechia from 2020 to 2025 in millions of CZK[4]

Type of income	2020	2021	2022	2023	2024	2025
VAT	426 198	463 265	535 734	566 727	583 634	622 628
Corporate Tax	155 998	195 964	228 676	304 087	283 291	324 050
Windfall Tax	—	—	—	39 135	36 665	38 364
Personal Income Tax	5 735	9 629	13 963	15 004	15 169	21 877
Personal Income Tax – Employment	204 929	138 466	149 594	176 664	201 301	223 418
Withholding Tax	25 609	29 121	38 618	52 816	55 741	53 721

1 The decision to replace turnover taxes with value added taxes dates back to the 1960s, when the Commission drew up a series of directives. The First Council Directive 67/67/227/EEC of 11 April 1967 on the harmonisation of legislation of Member States concerning turnover taxes set the objective of introducing value added tax as early as 1 January 1970, with the implementation time limits being extended several times. Thus, the adoption of the 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 can be regarded as the culmination of harmonisation efforts in the sense of eliminating nine relatively separate national VAT systems and replacing them with a common system (ŠIROKÝ, Jan. *Daně v Evropské unii [Taxes in the European Union]*. 7th ed. Praha: Leges, 2018, p. 149.). However, its implementation deadline was also extended by Council Directive 83/648/EEC of 19 December 1983 on the harmonisation of the laws of the Member States relating to turnover taxes - extension of the deadline for the introduction of a common system of value added tax in the Hellenic Republic, which extended the deadline for Greece, which became a member of the European Union on 1 January 1981, until 1 January 1987 (BORIA, Pietro. *Taxation in European Union*. 2nd ed. Cham: Springer, 2017, p. 140.).

2 Article 2(1)(b) Council Decision (EU, Euratom) 2020/2053 of 14 December 2020 on the system of own resources of the European Union and repealing Decision 2014/335/EU, Euratom.

3 ŠEFČÍK, Michael. *Karuselové podvody [Carousel Frauds]*. Praha: Leges, 2018, p. 13.

4 The table contains taxes administered by the Financial Administration of the Czech Republic and the Customs Administration of the Czech Republic.

Type of income	2020	2021	2022	2023	2024	2025
Real Estate Tax	11 580	11 836	12 419	12 452	23 115	23 635
Road Tax	5 959	5 429	1 731	499	1 155	1 217
Solar Electricity Levy	2 167	2 104	5 048	4 113	4 825	5 239
Gambling Tax	10 637	11 042	16 450	18 325	20 403	22 887
Alcohol Tax	7 768	8 735	8 880	8 972	8 965	8 864
Beer Tax	4 497	4 252	4 536	4 502	4 472	4 320
Mineral Oil Tax	88 216	85 809	82 081	84 086	96 525	94 565
Wine Tax	445	483	553	490	489	491
Solid Fuels Tax	322	348	354	258	275	265
Gas Tax	1 418	1 569	1 444	1 363	1 614	1 804
Electricity Tax	1 503	1 573	1 557	1 464	1 500	2 683
Tobacco Taxes	59 487	56 223	59 354	50 861	56 888	59 100

Data source: Financial Administration of the Czech Republic,[5] Customs Administration of the Czech Republic,[6] Government Bill on the State Final Account of the Czech Republic for 2025[7]

The table is not included merely to demonstrate the fiscal size of VAT. Its relevance for the present analysis lies in the combination of two features. VAT is fiscally indispensable and structurally exposed to non-compliance. A loss in VAT collection is therefore not merely an isolated enforcement failure in a single tax but it affects one of the principal channels through which public budgets are financed. The European Commission's VAT gap methodology provides an additional indication of the scale of this problem. The VAT gap is not identical with VAT fraud, because it may also reflect insolvency, administrative errors, bankruptcies or other forms of non-compliance, but it is an important proxy for the vulnerability of the VAT system.[8] In the Czech case, this vulnerability must be assessed against a legal environment in which the core VAT rules are harmonised at EU level, while the practical configuration of registration, reporting, control, securing and sanctioning instruments remains

5 The statistics of taxes administered by the Financial Administration of the Czech Republic are available at: https://financnisprava.gov.cz/cs/dane/analyzy-a-statistiky/udaje-z-vyberu-dani

6 The statistics of taxes administered by the Customs Administration of the Czech Republic are available at: https://celnisprava.gov.cz/cz/dane/WebTool/WebStat/Stranky/default.aspx For the various forms of tobacco taxation, I used the annual reports of the Customs Administration of the Czech Republic available at: https://celnisprava.gov.cz/cz/statistiky/Stranky/vyrocni-zpravy.aspx

7 The Government Bill on the State Final Account of the Czech Republic for 2025 is available at: https://mf.gov.cz/cs/rozpoctova-politika/statni-rozpocet/plneni-statniho-rozpoctu/2025/vladni-navrh-statniho-zaverecneho-uctu-ceske-repub-63848

8 According to the VAT Gap in the EU Report 2025, the VAT compliance gap in Czechia for 2023 was estimated at approximately CZK 50 108 million, corresponding to 8.0% of the theoretical VAT liability, while the estimated EU average was 9.5% (European Commission. *VAT Gap in the EU. Report 2025*. Luxembourg: Publications Office of the European Union, 2025, p. 80.).

largely national. The Czech system is therefore a useful case study of how a Member State combines EU-based VAT architecture with domestic administrative, procedural, criminal and anti-money-laundering tools. The recent EU VAT in the Digital Age package confirms that the fight against VAT fraud is increasingly connected with digital reporting, platform-based transactions and cross-border data exchange.

VAT is the tax most strongly associated with tax evasion, tax fraud, tax avoidance and other terms referring to usually deliberate non-compliance with tax obligations. This is due not only to the importance of this tax for public revenues, but also to the susceptibility of VAT to tax evasion and the actual extent to which VAT evasion occurs. This topic has long been of interest to scholars and to the relevant authorities, which draw attention to VAT fraud and seek to prevent and detect it.[9] This book does not seek to describe every technical rule of Czech VAT law. Its purpose is to identify, explain and systematise the instruments through which Czech law responds to VAT fraud. The central argument is that these instruments cannot be properly understood if they are treated as a homogeneous set of anti-fraud measures. They operate at different moments, address different risks and affect different legal positions. Some instruments reduce the opportunity for fraud before it occurs, some make fraudulent chains visible to the tax authorities, some seek to restore the fiscal position once the fraud has affected public revenues, and some impose punishment. The analytical value of the book therefore lies in distinguishing the primary function of each instrument and in showing how these functions complement, overlap or occasionally compete with one another.

The aim of this book is to construct a functional system of instruments used in Czech law to combat VAT fraud. The term "system" is used deliberately. It does not mean that all instruments are codified in one statute or administered by one authority. Rather, it denotes a structured set of legal mechanisms which, despite being dispersed across VAT law, tax procedure law, criminal law and anti-money-laundering law, pursue a shared objective of protecting the integrity of VAT assessment and collection. To achieve this aim, the book first explains the VAT features that make fraud possible, especially the deduction mechanism, fiscal neutrality and the treatment of cross-border supplies. It then defines VAT fraud for the purposes of the analysis and distinguishes it from neighbouring concepts such as tax avoidance and tax evasion. The core part of the book identifies individual Czech instruments and examines their legal construction and practical role. The final part classifies those instruments according to their primary functions, namely prevention, detection, restoration and retribution.

To achieve this objective, the book answers the following research questions:

1. Which characteristics of VAT make it structurally vulnerable to fraud, especially in cross-border supply chains?

[9] See European Court of Auditors. *Tackling intra-Community VAT fraud: More action needed. Special Report.* Luxembourg: Publications Office of the European Union, 2016. ISBN 978-92-872-3827-6. Available at: https://www.eca.europa.eu/en/publications/SR15_24

2. How should VAT fraud be defined for the purposes of analysing Czech anti-fraud instruments?
3. Which legal instruments does Czech law use to combat VAT fraud, and how are they located within VAT law, tax procedure, anti-money-laundering law and criminal law?
4. What is the primary function of each instrument, and how do these instruments interact as a system?

The book proceeds doctrinally and analytically. It first describes the legal construction of each relevant instrument, then analyses its function, legal limits and position within VAT administration, and finally synthesises the instruments into a functional classification. The analysis is based primarily on Czech legislation and case law, with EU law examined where it frames, requires or limits Czech regulation. The book does not seek to measure the statistical effectiveness of each instrument or to reconstruct individual fraud cases. Its focus is the legal design, function and mutual relationship of the instruments available under Czech law.

The structure of the book follows this analytical sequence. Chapter 1 sets out the VAT mechanism itself. It explains why the same features that make VAT neutral for taxable persons also expose it to the fraudulent extraction of deductions or to the disappearance of tax at particular points in the supply chain. This chapter is not a general textbook account of VAT. Instead, it focuses only on those characteristics that are relevant for fraud, especially the deduction mechanism, exemption with the right to deduct, and the territorial allocation of taxation.

Chapter 2 defines VAT fraud and presents its basic typology. This is necessary because Czech legislation does not contain a single statutory definition of VAT fraud and because the terms tax avoidance, tax evasion and tax fraud are often used inconsistently. The chapter therefore establishes the conceptual framework used in the rest of the book.

Chapter 3 analyses the individual instruments used in Czech law to combat VAT fraud. It examines instruments embedded directly in the VAT system, such as reverse charge, reporting obligations, denial of deduction or exemption, registration-related measures and securing mechanisms. It also includes selected tools from tax procedure, anti-money-laundering regulation and criminal law, because VAT fraud is not addressed exclusively through VAT law.

Chapter 4 then synthesises the preceding analysis. It classifies the instruments according to their primary functions, namely preventive, detection, restorative and retributive functions, and explains how they interact within a single functional system. This classification makes it possible to distinguish instruments that prevent the tax loss from arising, instruments that make the fraudulent chain visible, instruments that protect or reconstruct the fiscal position, and instruments that punish culpable conduct.

2 VALUE ADDED TAX

This chapter does not provide a general textbook description of VAT. Its purpose is narrower as it focuses on those structural features of VAT that are legally relevant for the emergence, detection and legal treatment of VAT fraud. VAT is a tax built on neutrality, deduction and the allocation of taxation to the place of consumption. These features make VAT economically efficient and compatible with cross-border trade, but they also create specific vulnerabilities. The tax is collected in stages, the person who remits the tax is usually not the person who ultimately bears its burden, and the right to deduct or recover input tax may arise before the tax authorities are able to verify the whole supply chain. For this reason, VAT fraud is not merely an external disturbance of an otherwise simple tax. It exploits the internal logic of the tax. The later analysis of Czech anti-fraud instruments must therefore begin with the mechanism of VAT itself.

2.1 Characteristics of value added tax

The essence of VAT, as is evident from its name, is the taxation of added value. It is thus the taxation of the part of the value of the goods or services sold that the seller adds to the value of the goods being purchased.[10]

A terminological clarification is necessary for readers who are not familiar with Czech VAT law. This book uses the term taxable person for a person carrying out an economic activity within the meaning of the VAT Directive, and the term VAT payer for a taxable person who has the status of a registered payer under the Czech VAT Act. This distinction is important because some forms of VAT fraud arise before formal VAT payer status is obtained, for example through the concealment of turnover relevant for registration, while other frauds involve registered VAT payers, identified persons, recipients of supplies, or persons participating in cross-border supply chains.

Only value added is taxed through the input tax deduction mechanism. A VAT payer is generally required to declare output tax on the full consideration received for its taxable supplies. At the same time, it may deduct the input tax charged on supplies received and used for its taxable economic activity.[11] The result is that the

[10] TÝČ, Vladimír. *Základy práva Evropské unie pro ekonomy [Basics of European Union Law for Economists]*. 7th ed. Praha: Leges, 2017, p. 278.

[11] DĚRGEL, Martin. Způsob krácení odpočtu DPH [The Methods of Reduced Deduction]. *Daně a právo v praxi [Taxes and Law in Practice]*, 2010, vol. 7, no. 10, p. 10.

VAT payer ultimately remits tax only on the value it has added. This ensures that the final consumer of the goods or services ultimately bears the total tax,[12] because the final consumer has no right to deduct the tax paid. The mechanism also ensures that the VAT is neutral for the VAT payers, as it does not enter into their costs. Only part of the administration of the tax is delegated to VAT payers, and the tax "flows through" them without affecting their costs and revenues.

From an anti-fraud perspective, the deduction mechanism has a double character. It is the legal instrument through which neutrality is achieved, but it is also the point at which VAT becomes vulnerable. Each VAT payer in the chain simultaneously collects output tax for the State and asserts a claim against the State in the form of input tax deduction. If output tax and input tax arise in a properly functioning chain, the mechanism is fiscally neutral for businesses and revenue is ultimately collected at the level of final consumption. If, however, one link in the chain fails to declare or pay output tax while another link claims deduction, the deduction mechanism may transform the unpaid tax into a direct loss for the public budget. This is particularly visible where an excessive deduction is claimed. The problem is therefore not simply that VAT is evaded, but that the legal system may be asked to recognise a deduction or refund which corresponds to tax that has not been effectively collected.

This principle of neutrality is not expressly set out in Czech legislation.[13] However, it is inherent in EU harmonisation[14] and is reflected in the VAT Directive, which states in Article 1(2) that "the common system of VAT entails the application to goods and services of a general tax on consumption exactly proportional to the price of the goods and services, regardless of how many transactions take place in the production and distribution process before the stage at which the tax is charged. On each transaction, VAT, calculated on the price of the goods or services at the rate applicable to such goods or services, shall be chargeable after deduction of the amount of VAT borne directly by the various cost components. The common system of VAT shall be applied up to and including the retail trade stage." The principle of neutrality of VAT is then explained through the system of deductions in the case law of the CJEU,[15] according to which this fiscal neutrality consists in the fact that the tax is not accumulated in the supply chain and "is not a real cost for the individual taxable persons who, when using the goods or services purchased for their taxable

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12 SCHENK, Alan; OLDMAN, Oliver. *Value Added Tax. A Comparative Approach*. New York: Cambridge University Press, 2008, p. 17.

13 BRANDEJS, Tomáš; DRÁBOVÁ, Milena; DUŠEK, Michal; HOLUBOVÁ, Olga; TOMÍČEK, Milan. *Zákon o dani z přidané hodnoty. Komentář [Value Added Tax Act. Commentary]*. 8th ed. Praha: Wolters Kluwer, 2019, p. 2.

14 AMAND, Christian. VAT Neutrality: A Principle of EU Law or a Principle of the VAT System? *World Journal of VAT/GST Law,* 2015, no. 3, pp. 163-181. Available at: https://doi.org/10.5235/20488432.2.3.163

15 E.g. CJEU case of 14 February 1985, C-268/83, *Rompleman.* CJEU case of 27 November 2003, C-497/01, *Zita Modes.* CJEU case of 15 January 1998, C-37/95, *Ghent Coal Terminal.*

economic activity, are always fully entitled to deduct the tax paid on the input."[16] VAT neutrality is therefore an essential component of the tax and must be reflected in all national legislation.[17] However, in addition to this fiscal neutrality (neutrality in the commercial chain), there is territorial neutrality.[18] This means that taxation occurs at the place of consumption,[19] and not in countries where other stages of production and supply are carried out. This form of neutrality is also closely linked to the issue of tax evasion, because taxation only at the place of consumption, combined with the deduction system, is a VAT weakness which creates space for the extraction of deductions to the detriment of the fiscus.[20]

This tension explains why anti-fraud instruments in VAT law cannot be understood as ordinary enforcement measures only. They often interfere with the very mechanisms which make VAT neutral. Denial of deduction limits fiscal neutrality, denial of exemption limits territorial neutrality, reverse charge alters the ordinary allocation of the obligation to declare tax, and reporting obligations transform private invoices into instruments of public risk analysis. The central legal problem therefore lies in balancing effective revenue protection with the preservation of VAT neutrality. If the state protects revenue too weakly, the deduction and exemption mechanisms may be abused. If it protects revenue too aggressively, VAT may cease to be neutral for honest taxable persons and cross-border trade may be burdened by excessive legal uncertainty. The instruments analysed later in this book should therefore be assessed according to how they allocate the risk of fraud between the State and taxable persons.

2.2 Tax exemption and the right to deduct

The essence of typical VAT fraud is the "loss" of tax at some stage of the economic chain (as discussed below). In many cases, this is done through a simulated or fictitious claim to a tax exemption, which results in an apparently legal claim for non-taxation of a specific transaction,[21] or a legal exemption, but implemented within a chain of transactions which as a whole seeks to obtain an unjustified reduction

16 ZÍDKOVÁ, Hana. Principy daně z přidané hodnoty [*Principles of VAT*]. *Bulletin Komory daňových poradců České republiky [Bulletin of the Chamber of Tax Advisers of the Czech Republic]*. 2019, no. 1, p. 26.

17 BORIA, ibid., p. 142.

18 DUGOVÁ, Alena. Neutralita v oblasti DPH [*Neutrality of the VAT*]. *Bulletin Komory daňových poradců České republiky [Bulletin of the Chamber of Tax Advisers of the Czech Republic]*, 2018, no. 4, p. 34.

19 SCHENK, OLDMAN, ibid., p. 183.

20 GREGGI, Marco. Neutrality and Proportionality in VAT: Making Sense of an (Apparent) Conflict. *Intertax*, 2020, no. 1, p. 122.

21 STRÉMY, Tomáš; HANGÁČOVÁ, Natálie. *VAT Frauds (Carousel Frauds)*. Praha: Leges, 2017, p. 50.

of tax liability (or even to secure a negative tax liability in the form of an excessive deduction).

The Czech VAT system distinguishes between two variants of exemptions, depending on their impact on the right to deduct input tax.[22] These are exemptions without the right to deduct tax and exemptions with the right to deduct tax.

The distinction is not merely technical. Exemptions without the right to deduct tax usually interrupt the deduction chain. The supplier does not charge output tax, but it also cannot deduct input tax connected with the exempt supply. Such exemptions may create classification disputes and may be misused if taxable supplies are falsely presented as exempt, but they do not normally create the same refund risk as exemptions with the right to deduct. Exemptions with the right to deduct are different. They remove output tax from a particular supply while preserving the supplier's right to deduct input tax. In functional terms, they produce an effect similar to zero-rating. This is justified where the supply should not be taxed in the state of origin, especially in cross-border situations. At the same time, it is precisely this combination of the absence of output tax on the exempt supply and the preservation of the input deduction that makes such exemptions central to missing trader and carousel fraud.

The detailed statutory list of exemptions without the right to deduct is not central to this book.[23] For the present analysis, the important point is functional. These exemptions usually interrupt the deduction chain because the supplier does not charge output tax and, correspondingly, cannot deduct input tax connected with the exempt supply. They may create disputes about classification, but they do not normally create the same refund risk as exemptions with the right to deduct. The latter are more important for VAT fraud because they preserve input deduction while removing output tax from the supply, especially in cross-border transactions.

In contrast, exempt supplies with a right to deduct tax preserve the VAT payer's right to deduct input tax, even though the VAT payer does not charge any output tax in connection with the exempt supply. Thus, in such cases, the VAT payer has no reason to reflect the amount of input tax in the consideration for the exempt transactions carried out by it, as it is entitled to deduct the input tax paid by its supplier.

For the purposes of this book, not all exemptions with the right to deduct are equally important.[24] The analytically decisive categories are those connected with cross-border movement of goods and services, because they separate the place where input tax is deducted from the place where output taxation is expected to occur. In ordinary trade this separation implements the destination principle. In fraudulent trade it may be used to create a chain in which input tax is deducted in one Member State, while the corresponding output tax is either not declared or not paid

[22] BRANDEJS, et al., ibid., p. 478.
[23] See sections 51–62 VAT Act.
[24] See sections 63–71l VAT Act.

in another part of the chain. This is why the exemption for the supply of goods to another Member State and the rules on the place of supply of services are not only technical rules on territorial allocation. They are also structural preconditions for the most serious forms of VAT fraud.

3 VAT FRAUD

3.1 Definition of tax fraud

The concept of tax fraud has no legal definition. Its definition is a task for legal science and practice. At the same time, however, various terms appear which have the same or similar meaning, or are used by professionals to refer to a variety of offences, as well as actions which are not illegal.[25] These are terms such as tax avoidance, tax evasion, or tax fraud.

The aim of this section is not to provide an ultimate definition of these terms, but only to define or distinguish them for the purposes of this book. The complexity, or rather instability, of the use of each term has been a long-standing problem, strongly influenced by the individual experience of each country and the limits of linguistic resources for describing individual phenomena.[26] This book does not attempt to resolve that terminological instability in general. It uses the distinction only functionally, in order to determine which type of conduct is relevant for the legal instruments analysed in the following chapters.

Tax avoidance is generally defined as conduct that does not directly violate the normative text of tax regulations, but is not in accordance with the purpose and meaning of the applied legal rules, as its predominant motivation is to gain a tax advantage.[27] Such conduct need not have criminal-law implications[28], nor need it have the purpose of violating tax-law norms.[29] It is the criminal law implications that typically distinguish the concept of tax avoidance from the concept of tax evasion.[30]

Tax evasion can generally be defined as a case where tax is not assessed and paid in accordance with the law. Thus, the tax liability deviates from the amount that should have been determined and paid if the legislation had been applied correctly,

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[25] SEJKORA, Tomáš. *Finančněprávní nástroje boje proti únikům na dani z přidané hodnoty v prostoru Evropské unie [Financial Law Instruments Combating Value-Added Tax Evasion in the Perspective of European Union]*. Praha: Leges, 2017, p. 22.

[26] For details see SEJKORA, ibid., p. 21–75.

[27] MERKS, Paulus. Tax Evasion, Tax Avoidance and Tax Planning. In *Intertax*, 2006, no. 5, p. 274. CACHIA, Franklin. Aggressive Tax Planning: An Analysis from an EU Perspective. *EC Tax Review*, 2017, no. 5, p. 257.

[28] BLUM, Daniel, SEILER, Markus. *Preventing Treaty Abuse*. Vienna: Linde, 2016, pp. 5–6.

[29] SEJKORA, ibid., p. 73.

[30] ROSENBLATT, Paulo. *General Anti-Avoidance Rules for Major Developing Countries*. Alphen aan den Rijn: Kluwer Law International, 2015, p. 21.

to the benefit of the tax subject (i.e., the VAT payer's tax liability is reduced or eliminated).[31]

In Czech criminal law, a narrower and codified form of tax evasion appears as the criminal offence of evasion of tax, fee and similar compulsory payment under section 240 Criminal Code. This does not mean that the term is completely isolated from the concept of tax evasion. However, the criminal offence is a narrower category of unlawful conduct requiring damage of at least CZK 100,000 (i.e., the amount of tax evaded)[32] and committed only in a form of culpability explicitly provided for by the law. The most important distinguishing feature is the anticipated form of culpability — while the crime of tax evasion presupposes culpability in the form of intent, negligence is sufficient to fulfil the features of tax evasion as a tax-law concept.[33]

The criminal offence of tax evasion consists in conduct by which the offender causes a mandatory payment to be assessed in an amount lower than that required by law or prevents its assessment altogether. This offence therefore concerns the unlawful reduction or concealment of the tax liability itself.[34] This unlawful conduct should not be confused with mere non-payment of the tax when it is correctly assessed.[35]

Tax fraud is defined by reference to the criminal offence of tax evasion, but primarily for the purposes of tax law. Thus, it is a deliberate unlawful act "by which another is misled, by taking advantage of another's mistake or by concealing material facts relevant to tax administration, thereby failing to correctly ascertain and fulfil the tax obligation of the tax subject, and at the same time causing damage to the property of the State and enriching the person committing tax fraud or another person."[36] Thus, in relation to VAT, the offence is that of misleading another, taking advantage of another person's mistake or concealing material facts in the administration of taxes, with the result that VAT is not correctly determined, assessed or secured for payment, which leads to damage consisting in a reduction in public budget revenue and enrichment of the person committing tax fraud or of another person.

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31 BOHÁČ, Radim. Teoretické a praktické otázky českého daňového práva z hlediska daňových úniků a podvodů [Theoretical and Practical Issues of the Czech Tax Law in the perspective of Tax Evasion and Fraud]. In: BABČÁK, Vladimír; ROMÁNKOVÁ, Anna; VOJNÍKOVÁ, Ivana (eds.). *Daňové právo vs. daňové podvody a daňové úniky: nekonferenčný zborník vedeckých prác. I. diel [Tax Law v. Tax Frauds and Tax Evasion. Collection of Scientific Papers. Volume 1]*. Košice: Univerzita Pavla Jozefa Šafárika, 2015, p. 38.

32 See section 138(1)(c) Criminal Code.

33 BOHÁČ, 2015, ibid., p. 38.

34 JELÍNEK, Jiří, et al. *Trestní právo hmotné [Substantive Criminal Law]*. 7th ed. Praha: Leges, 2019, p. 706.

35 ŠÁMAL, Pavel. *Trestní zákoník. Komentář [Criminal Code. Commentary]*. 2nd ed. Praha: C. H. Beck, 2012, p. 2453.

36 SEJKORA, ibid., p. 59.

For the purposes of VAT law, it is useful to distinguish between the fraud itself and participation in a transaction chain affected by fraud. The primary fraudulent act may be committed by the missing trader or by another person who conceals supplies, issues fictitious invoices, falsely claims an exemption, or fails to remit tax. However, several VAT consequences may affect different VAT payers in the chain. A VAT payer may formally satisfy the conditions for deduction or exemption and yet be denied that right because it knew or should have known that its transaction was connected with VAT fraud. This distinction is essential for the later analysis. Criminal liability focuses on the offender and requires the level of culpability prescribed by criminal law. Tax-law instruments, especially denial of deduction or exemption, may operate more broadly as they protect the functioning of the VAT system by refusing to recognise a right that is connected with fraudulent conduct.

3.2 Typology of VAT fraud

The following typology is not intended to be exhaustive. Its purpose is analytical and seeks to distinguish the main mechanisms through which VAT fraud affects the assessment, declaration, deduction or collection of tax. For this reason, VAT fraud can be grouped according to which part of the VAT mechanism is involved, including output tax, input tax, exemptions, place-of-supply rules and transaction chains. This typology also corresponds to the legal instruments analysed later in this book. Some instruments are directed primarily against the concealment of output tax, others against unjustified deductions, and others against the use of cross-border chains in which the tax loss arises at one level while a deduction or exemption is claimed at another.[37]

[37] For details see SEJKORA, ibid., pp. 76–98. ZÍDKOVÁ, Hana. *Daň z přidané hodnoty: Efektivita jejího systému a výběru v Evropské unii [VAT: Effectivity of the system and collection in the European Union]*. Praha: Oeconomica, 2023, pp. 23–26. ŠEFČÍK, ibid., pp. 22–27.

Table 2: Main types of VAT fraud and the VAT features they abuse

Mechanism of fraud	VAT feature abused	Typical fiscal effect	Instruments primarily relevant
Concealment or understatement of output tax	Self-assessment, registration thresholds, obligation to declare output tax	Tax is not assessed or is assessed too low	Registration measures, control reports, search activities, securing instruments, criminal liability
Unjustified input tax deduction	Deduction mechanism and invoice-based evidence	Tax liability is reduced or excessive deduction is claimed	Denial of deduction, control reports, evidentiary rules, securing instruments
False use of exemption, reduced rate or place-of-supply rule	Classification of supplies, exemptions, territorial allocation	Output tax is not charged where it should be charged	Denial of exemption, summary reports, VIES-related checks, control procedures
Missing trader / carousel fraud	Combination of cross-border exemption, deduction and staged collection	Tax is lost at one level while deduction or exemption is claimed at another	Reverse charge, reporting obligations, denial of deduction or exemption, guarantees, AML and criminal-law tools

Czechia applies a small-enterprise exemption. Under the current wording of the VAT Act, supplies that would otherwise be taxable are exempt in Czechia if they are made by a taxable person established in Czechia who is not a VAT payer, or by a person registered under the small-enterprise scheme for Czechia and entitled to use that scheme.[38] For a taxable person established in Czechia, VAT payer status generally arises from the first day of the calendar year immediately following the calendar year in which its turnover in Czechia exceeded CZK 2,000,000. If its turnover in Czechia exceeds CZK 2,536,500 in the relevant calendar year, it becomes a VAT payer on the following day.[39] Although this also entails the absence of the right to claim input tax deductions, it may be attractive for such persons to avoid VAT registration by concealing certain supplies and thus not counting them against turnover. A similar situation, again close to the so-called shadow economy, is the concealment of taxable supplies by the VAT payer. Under the current registration rules, concealment may therefore be aimed not only at remaining below the basic threshold, but also at avoiding immediate VAT payer status after exceeding the higher threshold. Thus, although the person is already registered as a VAT payer, that person deliberately refrains from taxing the supplies made (and typically offers its goods or services to the consumer at a lower price).[40] Furthermore, it is possible to

[38] Section 50 VAT Act.
[39] Sections 6(1) and (2) VAT Act.
[40] ZÍDKOVÁ, 2023, ibid., p. 23.

encounter deliberate misapplication of a lower tax rate[41] or exemption to otherwise taxable supplies, which again leads to a reduction in the tax liability of the VAT payer. All of these types of situations are linked by a form of fraudulent behaviour relating to output tax.

Because VAT is based on a deduction system, fraudulent behaviour may also concern input tax. In such a case, a tax deduction may be claimed on transactions for which the VAT payer does not meet the conditions defined for the right to deduct tax. Typically, the VAT payer acquires property which is not used in the course of economic activity or is only partially used.[42]

While such behaviour is indeed fraudulent and relatively common, it is not usually perceived as the most serious form of VAT evasion. In contrast, carousel fraud is a systemic abuse of VAT. This type of fraud seeks to take advantage of the successive taxation of value added at different levels of the distribution chain, with the result that at some stage the tax is "lost" in the form of non-declaration and non-payment or declaration and non-payment.[43] This corresponds to the terminology used for these frauds in some European Commission documents, which refer to them as MTIC frauds (*missing trader intra-community frauds*).[44] Carousel fraud schemes are sometimes treated as a type of MTIC fraud together with acquisition fraud. However, they do not differ in principle. The only difference is the level of the chain at which the tax is lost.[45] Given the increasing complexity of fraudulent chains, I consider this distinction to be essentially meaningless.

The use of carousel fraud is characterised by the involvement of persons from more than one Member State, as both the fiscal and territorial neutrality of VAT is abused. In carousel trade, the missing trader is the key element, acquiring goods from another Member State without paying tax on them. The trader then sells the goods to another trader (broker) through other persons (buffers), and these brokers supply the goods to another Member State using the exemption. The goods are then re-delivered to the missing trader, thus completing the chain and forming an imaginary carousel.[46] [47]

In the case of carousel fraud involving supplies of services, the principle of loss of tax is the same. However, the legal instrument for determining the place of

41 Under the current wording of the VAT Act, the standard VAT rate in Czechia is 21 %, while the reduced VAT rate is 12 % (see sections 47 and 47a VAT Act).

42 If the property is partially used, the VAT payer can make a proportionate deduction of the input tax (see section 75 VAT Act.).

43 ZÍDKOVÁ, 2023, ibid., p. 24.

44 E.g. European Commission. *VAT Gap in the EU. Report 2025*. Luxembourg: Publications Office of the European Union, 2025.

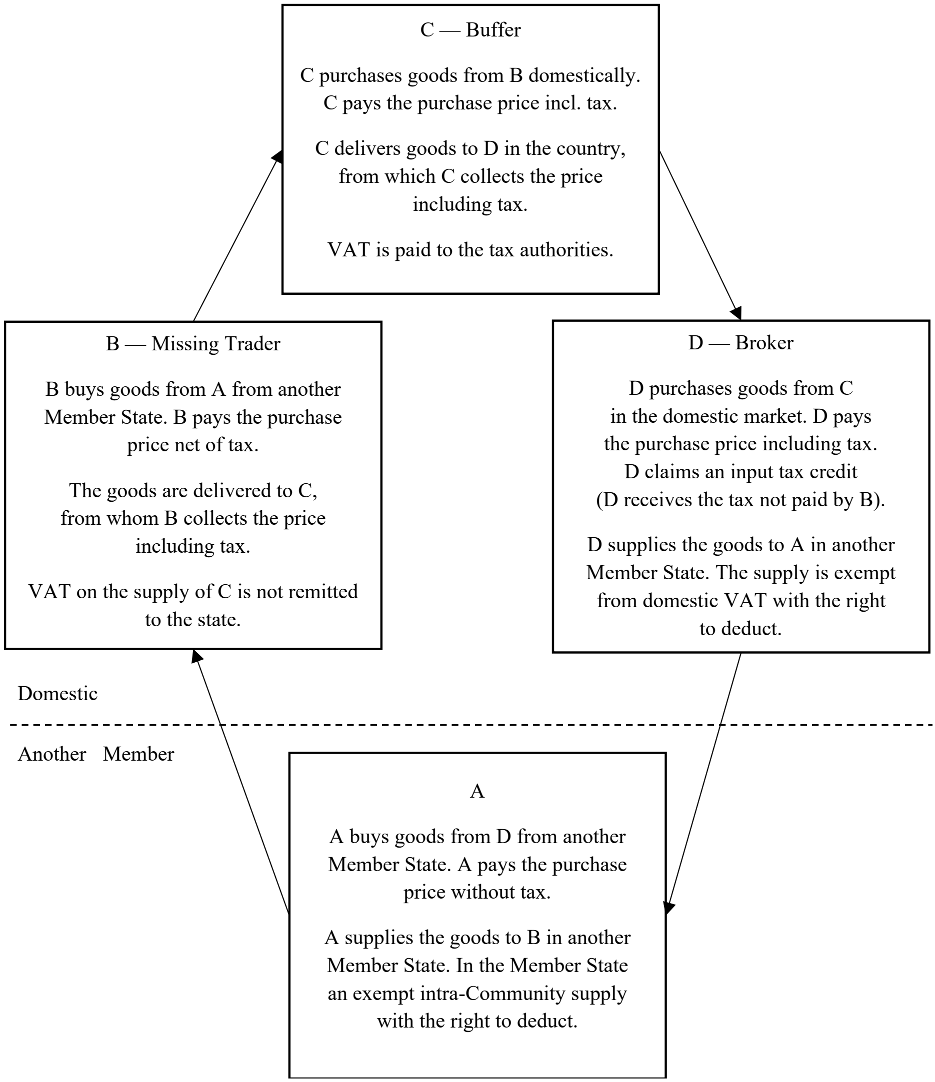
45 ŠEFČÍK, ibid., p. 38.

46 KEEN, Michael; SMITH, Stephen. VAT fraud and evasion: What do we know, and what can be done? *IMF Working Paper*, 2007, WP/07/31, p. 13.

47 Re-delivery to the missing trader is not present in acquisition fraud (see KOUPIL, Vít. Karuselové podvody. Jak je poznat a vést v nich dokazování [Carousel Frauds. How to Identify Them and deal with Evidence]. *Státní zastupitelství [Public Prosecution]*, 2014, no. 5, p. 11.).

taxation differs — in the case of services, it is the use of the place of supply determination for the supply of services to a taxable person[48], whereas for the supply of goods to another Member State, the relevant instrument is the exemption for the supply of goods to another Member State.[49]

The basic scheme of carousel fraud is as follows:



Based on KEEN, Michael; SMITH, Stephen. VAT fraud and evasion: What do we know, and what can be done? *IMF Working Paper*, 2007, WP/07/31, p. 13.

48 E.g. section 9 VAT Act.
49 Section 64 VAT Act.

In practice the whole sequence of transactions is considerably more complicated, as the chain may also involve sales through hundreds of persons,[50] the involvement of entities outside the EU, and the combination of the supply of goods and the provision of services.[51]

The importance of carousel fraud lies not only in the amount of tax that may be lost, but also in the way in which the loss is legally distributed across the chain. The missing trader is usually the person at whose level the tax is not remitted, but the economic benefit of the fraud may be realised elsewhere in the chain, for example by a broker claiming deduction or by participants sharing the margin created by the unpaid tax. Buffers make the chain appear commercially ordinary and make it harder to prove the connection between the claimant of deduction or exemption and the tax loss. Carousel fraud therefore challenges the traditional model of tax enforcement, which is based on the individual tax liability of a particular VAT payer. It requires instruments capable of reconstructing the chain, identifying the link between transactions and the tax loss, and deciding whether the legal consequences should affect only the missing trader or also other participants.

The typology set out above remains valid even in a digitalised VAT environment. Digital reporting, platform-based transactions and cross-border payment data change mainly the speed and quality of detection, not the underlying legal mechanisms of VAT fraud. This issue is therefore analysed below in connection with reporting obligations and detection instruments.

[50] LICHNOVSKÝ, Ondřej; VUČKA, Jan; KŘÍSTEK, Lukáš. *Trestní právo daňové [Tax Criminal Law]*. Praha: C. H. Beck, 2020, p. 226.

[51] See ŠEFČÍK, ibid., pp. 31–36.

4 INSTRUMENTS TO COMBAT VAT FRAUD

This chapter does not treat the instruments against VAT fraud as a mere catalogue of legal measures. Their legal significance becomes clear only when they are examined according to the risk which they address within the VAT mechanism. VAT fraud may arise before registration, during the creation of a transaction chain, at the moment of invoicing and reporting, during the assessment of a deduction or exemption, or at the later stage of securing and enforcing payment. A single anti-fraud instrument may therefore have more than one practical effect. Nevertheless, each instrument has a dominant function which determines its place in the system.

The analysis in this chapter follows three questions. First, it asks which structural weakness of VAT the instrument addresses. Secondly, it asks at what moment the instrument intervenes, whether before the fraud occurs, while the fraudulent chain is being detected, after the tax loss has materialised, or only once the conduct is punishable. Thirdly, it examines whose legal position is affected by the instrument, including the fraudulent person, another taxable person in the chain, the tax administration, obliged persons under anti-money-laundering law, or law-enforcement authorities.

This functional approach is necessary because the Czech system does not combat VAT fraud through one coherent statutory regime. The relevant instruments are dispersed across the VAT Act, the Tax Procedure Code, legislation on international administrative cooperation, anti-money-laundering law and criminal law. Some measures change the ordinary operation of VAT itself, such as reverse charge. Others do not change substantive VAT liability, but increase the information available to the tax administration, such as control reports, summary reports and payment data. A third group protects the public budget after a tax loss has become likely or has already occurred, for example denial of deduction, liability for unpaid tax, security orders or liens. Criminal law then operates at a different level, because it is not primarily designed to reconstruct the VAT position but to punish conduct which reaches the threshold of criminal liability.

For that reason, the chapter distinguishes between preventive, detection, restorative and retributive instruments. This classification is not absolute. It identifies the primary function of each instrument, while acknowledging that many instruments also have secondary effects.

4.1 Reverse Charge

The essence of the reverse charge is the transfer of the obligation to declare and pay tax from the supplier to the recipient. However, it is not a change in the tax subject, but a change in a partial obligation arising from the general position of the tax subject, or a "substantive transfer of the tax subject's obligation to pay the tax".[52] Indeed, if the tax subject is defined as the person whose activity, income, or thing is subject to tax,[53] the tax subject must follow the object of the tax. In the case of reverse charge, the subject matter of the tax is the supply of goods or services, but the obligation to declare and pay the tax is reversed without any change in the person whose "added value" is subject to VAT. However, the situation is different in the case of the obligation to declare tax on the acquisition of goods from another Member State or on import, as these activities are separately defined in the object of VAT.

The general legal regulation of the reverse charge regime is provided for in section 92a VAT Act. The current wording also defines several important limitations. The reverse charge regime is not used where the recipient is not acting as a taxable person, where the supply consists of a forced sale of a VAT payer's business assets, or during the period before the VAT payer status of the relevant parties has been published in a manner allowing remote access. Conversely, if both parties reasonably assume that a taxable supply is subject to the reverse charge regime and apply that regime, the supply is treated as a taxable supply subject to the reverse charge regime. In addition to the basic rule of the regime itself, i.e., the creation of the obligation to declare tax by the VAT payer for whom the taxable supply with the place of supply in Czechia was carried out on the date of the supply, the legal regulation contains other obligations. That VAT payer is obliged to calculate the tax and is responsible for the correctness of this calculation[54] — the VAT payer is thus obliged to correctly apply the relevant tax rate and to calculate the tax itself. It therefore cannot rely, for example, on the incorrect tax rate on the tax invoice issued by the supplier of goods or services. The supplier is under no obligation to classify the tax rate or to calculate the tax on the tax invoice.[55]

From a functional perspective, reverse charge is not important merely because it transfers a reporting and payment obligation. Its anti-fraud value lies in changing the allocation of VAT risk within the transaction. Under the ordinary VAT mechanism, the supplier charges VAT to the customer, receives the tax component of the price and is then expected to remit it to the state. If the supplier disappears or becomes insolvent, the customer may still claim input tax deduction, while the output

[52] SEJKORA, ibid., p. 155.
[53] BOHÁČ, 2013, ibid., p. 79.
[54] Section 92a(5) VAT Act.
[55] VONDRAŠ, Petr; PANTŮČEK, Igor. *Zákon o dani z přidané hodnoty. Praktický komentář [VAT Act. Practical Commentary]*. Praha: Wolters Kluwer, 2024, p. 533.

tax is not effectively collected. This is the core vulnerability exploited in missing trader fraud.

Reverse charge removes this vulnerability at the level of the covered transaction. The supplier no longer receives the VAT component of the price. The recipient declares output tax and, if the conditions for deduction are met, simultaneously deducts the same amount as input tax. The transaction is therefore neutral for the recipient and does not generate a cash-flow position in which the supplier can retain tax collected from the customer. In this sense, reverse charge prevents the emergence of the tax loss rather than merely improving the chance of detecting or recovering it.

This also explains the limits of the instrument. Reverse charge does not prove that the underlying transaction is genuine, nor does it eliminate all forms of VAT fraud. It is effective primarily against fraud based on the disappearance of the person who received VAT from another VAT payer. It is less effective where the fraud consists in fictitious supplies, false classification of the transaction, manipulation of the tax base, or fraud at the final consumption stage. Moreover, because reverse charge is applied only to selected categories of supplies, VAT payers and tax authorities must determine whether a particular transaction falls within the regime, which creates boundary problems. These boundary issues explain the importance of binding rulings and also show that reverse charge replaces one type of risk with another, because it reduces collection risk but increases classification risk.

The range of transactions for which the tax liability is transferred has gradually expanded in the history of VAT — initially from the supply of gold of a specified purity and form between VAT payers to the current definition in the text of the VAT Act itself and in its Annexes 5 and 6. This is therefore a targeted reverse charge for supplies of goods or services where there is a strong interest in reducing the risk of tax fraud.[56]

In practice, confusion may arise when classifying a particular supply of goods or services as a supply subject to reverse charge. To increase the legal certainty of VAT payers, the VAT Act allows for a request for an advance ruling on the assessment of a particular supply for reverse charge.[57] This allows the VAT payer to obtain an advance ruling on whether the reverse charge regime applies to a specific type of supply, similar to the advance ruling on the correct tax rate[58] or for the application of the tax exemption with entitlement to deduction for the supply of a book or a similar service.[59] However, this decision is issued on request and is binding only in relation to the specific VAT payer (the applicant for the advance ruling). The decision is then binding on the tax authorities, who decide on the tax liability in the tax proceedings, unless there is a change in the state of affairs.[60]

56 ZÍDKOVÁ, 2023, ibid., p. 28.
57 Section 92h and 92i VAT Act.
58 Section 47b VAT Act.
59 Section 71k VAT Act.
60 Section 133(1) Tax Procedure Code.

4.1.1 Permanent reverse charge regime

The list of supplies subject to reverse charge under the permanent scheme is contained directly in the VAT Act and its Annex 5.

In the first place, the supply of gold to the VAT payer in the course of its economic activity is subject to the permanent scheme.[61] This is the oldest use of the reverse charge.[62] It is applied to the supply of gold in exhaustively defined situations:

- delivery of gold with a purity of 333/1000 or higher in unwrought form,
- the supply of investment gold by a VAT payer who produced the investment gold or converted gold into investment gold and opts to tax that supply under section 92(5) VAT Act,
- an intermediary service consisting of arranging the supply of investment gold where the intermediary opts to tax that service under section 92(6) VAT Act.

It follows from the defined conditions that the transfer of tax liability for gold applies to the supply of non-investment gold in the forms listed in section 92b(1)(a) VAT Act, to taxable supplies of investment gold covered by section 92(5), and to intermediary services covered by section 92(6), provided that the recipient is a VAT payer.

While the use of the reverse charge for gold supplies is directly imposed by article 198 VAT Directive, the inclusion of other categories of supplies of goods or services under this regime is at the discretion of the Member States under article 199 VAT Directive. However, Czechia has made full use of this authorisation and therefore the tax liability is reversed for:

- the supply of processed and unprocessed waste and scrap according to Annex 5 VAT Act;
- the supply of immovable property to a VAT payer where the transaction is taxable because the supplier has opted to tax it under sections 55a(4), 56(8), or 62(3) VAT Act;[63]
- the provision of construction or assembly work corresponding to CZ-CPA production classification codes 41 to 43 or the provision of workers for these activities to the VAT payer;[64]
- the supply of goods provided as security in the enforcement of that security;[65]
- the supply of goods after the assignment of reserved ownership to the assignee and the exercise of that right by the assignee.[66]

[61] See section 92b(1) and (2) VAT Act.
[62] BRANDEJS, et al., ibid., p. 964.
[63] Section 92d VAT Act.
[64] Section 92e VAT Act.
[65] Section 92ea(a) VAT Act.
[66] Section 92ea(b) VAT Act.

4.1.2 Temporary reverse charge regime

As the designation suggests, the essence of the temporary reverse charge scheme is its temporary nature (time limitation). Therefore, article 199a VAT Directive provides that Member States may also use reverse charge for other exhaustively defined supplies until 31 December 2026.[67] Specifically, these are:

- the transfer of greenhouse gas emission allowances;
- the delivery of mobile phones;
- the supply of integrated circuit devices (e.g., microprocessors and central processing units) in a state prior to incorporation into the product for the end user;
- the supply of gas and electricity to a trader pursuant to section 7a(2) VAT Act;
- the delivery of gas and electricity certificates;
- the provision of telecommunications services;
- the delivery of game consoles, tablets, and laptops;
- the supply of cereals and industrial crops, including oilseeds and sugar beet;
- the supply of raw or semi-processed metals or precious metals (except those falling under the permanent reverse charge regime or the special regimes in section 90 or 92 VAT Act);
- supplies of goods or services for which a special measure derogating from article 193 VAT Directive has been authorised by a Council implementing decision.

Although the existence of the reverse charge scheme is already provided for in section 92f VAT Act, this provision allows its application only if the government so provides in its regulation. Czechia has again made full use of the authorisation granted by the VAT Directive (except for the situation described in the final item). Therefore, Government Regulation No. 361/2014 Coll., determining the supplies of goods or services for the application of the reverse charge regime, as amended, provides for the application of the temporary reverse charge regime for all categories of goods and services defined in Annex 6 VAT Act.[68]

The Czech model is therefore a sectoral reverse charge model. It does not abolish the ordinary fractional collection system of VAT. It only removes selected high-risk transactions from that system. This selectivity is both its strength and its weakness. It is a strength because it limits interference with the ordinary VAT mechanism to sectors in which fraud risk is regarded as sufficiently serious. It is a weakness because fraudulent activity may migrate to sectors or types of supplies that remain outside the regime. In addition, sectoral reverse charge requires precise legal classification of supplies, which may itself become a source of disputes and legal uncertainty.

A general reverse charge would address this limitation by removing the missing-trader vulnerability from all B2B transactions. However, such a model would

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[67] The deadline has been repeatedly extended (see SEJKORA, ibid., p. 167.).

[68] See section 2(2) Government Regulation No. 361/2014 Coll., on Determining the Supply of Goods or Services for the Application of the Reverse Charge Regime, as amended.

also substantially alter the logic of VAT as a staged tax. It would concentrate the effective collection of tax closer to the final consumer and would reduce the built-in self-checking effect of output tax and input tax at each stage of the chain. For this reason, the Czech system should be understood as a compromise because it uses reverse charge preventively but only where the expected anti-fraud benefit outweighs the systemic cost of deviating from the ordinary VAT mechanism.

In addition to the possibility to issue a regulation for supplies defined in Annex 6 of the VAT Act, it is possible to issue a regulation for the application of the reverse charge regime under the so-called Quick Reaction Mechanism (QRM). In order to use this mechanism, the European Commission must confirm that it has no objection to the application of the reverse charge regime to other categories of supplies in order to combat sudden and large-scale tax evasion.[69] The duration of the application of QRM must not exceed nine months and must in any event not extend beyond 31 December 2026.[70]

However, if it is necessary to use the measure for a longer period of time, it would be possible to use the special-measures mechanism under article 395 VAT Directive (this is also foreseen in the last point of Annex 6 VAT Act, which is mentioned above). This is a specific legal arrangement which is not covered by article 199b VAT Directive, as transposed into section 92g VAT Act (QRM). However, this does not preclude the possibility that these regimes may build on each other. The QRM allows for an immediate response to tax fraud in relation to a specific category of transactions at risk. At the same time, it will create space, for example, for the adoption of a special measure under article 395 VAT Directive. However, such a special measure will again be limited in time, usually to 3 years.[71]

So far, Czechia has not used the QRM or the reverse charge on the basis of a special measure.[72]

4.2 Reporting obligations

Reporting obligations form the information layer of the anti-fraud system. They do not normally change the substantive VAT liability and they do not themselves restore a tax loss. Their function is different because they reduce the information asymmetry between taxable persons and the tax administration. VAT fraud is often possible because the tax authority sees individual tax returns, while the fraudulent

69 In addition to the wording of section 92g(1) VAT Act, article 199b(1) VAT Directive requires the risk that VAT fraud will lead to "substantial and irreparable financial losses."

70 See article 199b(6) VAT Directive.

71 See the explanatory memorandum to Act No. 360/2014 Coll., amending Act No. 235/2004 Coll., on Value Added Tax, as amended, and other related acts, p. 62.

72 BRANDEJS, et al., ibid., p. 979. VONDRAŠ, PANTŮČEK, ibid., p. 545.

arrangement exists at the level of a chain of transactions. Reporting obligations make it possible to reconstruct that chain.

The Czech system contains several reporting instruments which operate at different levels. Control reports provide transaction-level information on domestic VAT relations. Summary reports connect domestic data with cross-border supplies within the EU and with the VIES infrastructure. Records of cross-border payments add a payment-based layer, particularly relevant for e-commerce, where the taxable person may have no physical presence in the Member State of consumption. Reporting obligations under the Act on International Cooperation operate at an even broader level and may provide information about platform activity, financial accounts, cross-border arrangements or other structures relevant to tax risk.

These instruments should therefore not be assessed separately only according to their formal statutory source. Their analytical value lies in their cumulative effect. Together they allow the tax administration to compare invoices, declarations, payments, registration data and cross-border information. They transform VAT administration from a system based mainly on *ex post* verification of tax returns into a system based increasingly on risk analysis and data matching.

4.2.1 Control reports

The control report is a tax filing within the meaning of the Tax Procedure Code, but it differs from a VAT return. Its purpose is not to assess the VAT payer's VAT liability directly, but to transmit structured transaction data kept under the VAT record-keeping obligations.[73] The report enables the tax authorities to detect organised tax evasion by analysing the data obtained, to analyse VAT obligations more generally, and to target supervisory activities.[74] Thanks to the control report, the tax administration obtains information on transactions subject to VAT at monthly intervals. This enables the tax authorities to carry out timely transaction matching and to identify links between taxable persons through which an excessive deduction may be claimed although the corresponding output tax has not been properly declared or paid. The control report is therefore particularly important where VAT fraud is structured as a chain because it allows the tax administration to compare the transaction reported by the supplier with the deduction claimed by the recipient.[75]

[73] The registration obligation is imposed on VAT payers and identified persons under sections 100 and 100a VAT Act and on operators of the electronic interface under section 100b VAT Act.

[74] Explanatory memorandum to Act No. 360/2014 Coll., amending Act No. 235/2004 Coll., on Value Added Tax, as amended, and other related acts, p. 64.

[75] However, some authors point out that this measure alone does not lead to the elimination of VAT fraud (SEMERÁD, Pavel and BARTŮŇKOVÁ, Lucie. VAT Control Statement as a Solution to Tax Evasion in the Czech Republic. *Social and Behavioral Sciences*, 2016, no. 220, p. 422.).

The functioning of the control report is based on reporting data in a prescribed structure and format,[76] which allows for a machine-readable form of data.[77] Such a submission then allows these data to be processed automatically by collating and matching information on individual transactions.

The VAT payer is obliged to submit a control report if it:

a) has carried out a taxable supply with the place of supply in Czechia or has received, prior to the date of such supply, a consideration on which the obligation to declare the tax arose;
b) has become obliged to declare tax on the supply received with the place of supply in Czechia under sections 108(2–3) or 108(4)(a) of the VAT Act;
c) claims a deduction for input tax;
d) handles investment gold under a special regime under section 92 VAT Act.

The specific content of the control report is defined by Decree No. 387/2025 Coll., on VAT form submissions. The control report is contained in Annex 12 to that decree; transactions are reported in the individual sections of the control report as follows:

- Section A.1 — Taxable supplies carried out under the reverse charge regime, for which the recipient of the supply is obliged to declare tax under section 92a VAT Act;
- Section A.2 — Received taxable supplies for which the recipient is obliged to declare tax under section 108(2) and (3) VAT Act;
- Section A.3 — Transactions carried out under the special regime for investment gold under section 101c(c)(2) VAT Act;
- Section A.4 — Taxable transactions and payments received with the obligation to declare tax under section 108(1) VAT Act with a value of more than CZK 10,000 including tax and all corrections made in relation to bad debts regardless of the limit;
- Section A.5 — Other taxable supplies made and consideration received with the obligation to declare tax under section 108(1) VAT Act with a value of up to CZK 10,000 including tax, or supplies for which there is no obligation to issue a tax document;
- Section B.1 — Taxable supplies received under the reverse charge regime for which the recipient is obliged to declare the tax under section 92a VAT Act;
- Section B.2 — Taxable supplies received and consideration given for which the recipient claims a tax deduction under section 73(1)(a) VAT Act with a value of more than CZK 10,000 including tax and any adjustments to the deduction in respect of bad debts, irrespective of the limit;
- Section B.3 — Taxable supplies received and consideration provided, for which the recipient claims a tax deduction under section 73(1)(a) VAT Act, with a value of up to CZK 10,000 including tax.

[76] See section 72(2)(c) Tax Procedure Code.

[77] TULÁČEK, Michal. *Elektronizace správy daní [Tax Administration Electronisation]*. Praha: Leges, 2020, p. 72.

As follows from the breakdown above of the control report, taxable supplies and payments received with the obligation to declare tax and taxable supplies received and payments provided for which the recipient claims the right to input tax deduction are differentiated according to their value into i) those up to CZK 10,000 including tax and ii) supplies exceeding this value. This criterion follows the possibility of issuing a simplified tax invoice under section 30 VAT Act, for which the threshold of CZK 10,000 also applies. Transactions which fulfil the defined conditions are listed cumulatively in sections A.5 and B.3, respectively, for the period for which the control report is submitted.[78] This is a simplification for these small transactions, but it also results from the impossibility of reporting data on them in relation to specific persons as a simplified tax invoice does not have to contain, among other things, the name and tax identification number of the person for whom the transaction is carried out.[79] At the same time, it can be assumed that tax fraud primarily affects higher-value transactions, and therefore detailed monitoring of small transactions is not practical in this respect either, due to the administrative and technical complexity for both VAT payers and tax administrators. The possible "hiding" of transactions above CZK 10,000 in sections A.5 and B.3 would certainly attract the interest of the tax authorities in the case of larger volumes and would lead to an examination of the correctness of such reporting.

The control report should not be understood as a substantive anti-fraud rule. It does not determine whether a supply took place, whether the right to deduct exists, or whether the taxable person participated in fraud. It produces signals. A discrepancy between the supplier's and the recipient's reporting may indicate a false invoice, an omitted taxable supply, incorrect timing, an incorrect tax identification number, or a merely technical error. For that reason, the control report is analytically situated between ordinary VAT compliance and formal control procedures. It gives the tax administration a basis for selecting transactions and taxable persons for further verification.

This also explains why the control report is a detection instrument rather than a preventive or restorative one. It may have an indirect deterrent effect because taxable persons know that their reported transactions can be matched. However, its primary function is not to prevent the legal possibility of fraud, as reverse charge does, and not to restore a tax loss, as denial of deduction or securing instruments do. Its primary function is to make the fraudulent chain visible.

[78] Metodická informace k vyplnění kontrolního hlášení DPH ke dni 1. 1. 2024 [Methodological information on completing the control report as of 1 January 2024]. *financnisprava.gov.cz* [online], pp. 20 and 26. Available at: https://financnisprava.gov.cz/assets/cs/prilohy/d-seznam-dani/Metodicka_informace_k_vyplneni_KH_20240101.pdf

[79] Section 30a(1)(a) and (b) VAT Act.

4.2.2 Summary report

The summary report is a reporting instrument in relation to the supply of goods and services to other Member States, which is closely related to the abolition of physical customs controls at the EU's internal borders.[80] The content of the summary report is the tax identification number of the customer, the classification of the transaction, the number of transactions in the reported calendar month, and the total value of the transactions expressed in CZK, in relation to cases where:

- the goods are supplied from the domestic territory to another Member State to a person registered to VAT in another Member State;[81]
- the goods are transferred from the domestic country to another Member State;[82]
- the goods are supplied in the form of a triangular transaction within the EU, the reporting taxable person being the middle person of that transaction;[83]
- a service is supplied with a place of supply in another Member State and the place of supply is governed by the place of residence of the customer, if the recipient of the service is liable to declare the tax;[84]
- the goods have been moved under the warehousing procedure from the domestic territory to another Member State.[85]

It follows from the above list that the VAT payer or the identified person does not report in the summary report all supplies made to taxable persons in another Member State. For example, the provision of services with a place of supply pursuant to sections 10 to 10i VAT Act or the provision of services which are tax exempt in the Member State concerned are not the subject of the summary report.[86]

The purpose of the summary report is to provide information to the State for the purpose of controlling the application of VAT on the movement of goods and services between different Member States. However, this information is not only used for the needs of the State but is exchanged across the EU through the VIES system.

VIES, or the Value Added Tax Information Exchange System, is the basic source of information for international cooperation in VAT administration. VIES provides its services primarily to tax authorities, giving them up-to-date data from Czechia and other Member States for the purposes of tax administration for specific entities and the performance of analytical activities in relation to the supply and its supply chain, as well as to the tax entities themselves. Moreover, the system enables the

[80] See recital to the Council Directive 91/680/EEC of 16 December 1991 supplementing the common system of value added tax and amending Directive 77/388/EEC with a view to eliminating tax frontiers.
[81] See section 64 VAT Act.
[82] See section 64(4) VAT Act.
[83] See section 17 VAT Act.
[84] See section 9(1) VAT Act.
[85] See section 18 VAT Act.
[86] VONDRAŠ, PANTŮČEK, ibid., p. 583.

validity of the tax identification number to be verified online throughout the EU. It is thus possible to determine whether a trading partner is registered for VAT.[87]

The summary report has a specific analytical importance in relation to the exemption of intra-Community supplies. In a fraud-free transaction, the exemption in the Member State of dispatch is mirrored by taxation of the acquisition in the Member State of arrival. The summary report is one of the instruments through which this mirroring can be verified. It does not itself prove that the goods were transported to another Member State, nor does it prove that the acquirer properly declared the acquisition. Nevertheless, it creates a cross-border data point which can be compared with information held by another Member State.

For that reason, the summary report is closely connected with the denial of exemption. Where a taxable person fails to report an intra-Community supply, reports it incorrectly, or reports a customer whose VAT identification number does not correspond to the transaction, this may create doubts about the substantive conditions of the exemption or about the taxable person's good faith. The reporting obligation therefore has a dual relevance. It is a detection tool for the tax administration and, at the same time, part of the evidentiary environment in which the VAT payer's claim to exemption is later assessed.

4.2.3 Records of cross-border payments

The obligation to keep records of cross-border payments and their recipients was added to the VAT Act with effect from 1 January 2024 by Act No. 417/2023 Coll., amending Act No. 235/2004 Coll., on value added tax, as amended, and other related acts. It implemented Council Directive (EU) 2020/284 of 18 February 2020 amending Directive 2006/112/EC as regards the introduction of certain requirements for payment service providers.

The directive was a follow-up to the simplification of the one-stop shop scheme,[88] which allowed for a simplified procedure for the administration of VAT obligations for VAT obligations relating to e-commerce, including services and distance sales of goods. This scheme was intended to ensure better implementation of the principle of taxation at the place of consumption (i.e., the manifestation of territorial neutrality of VAT). At the same time, there was a need to introduce an instrument that would contribute to detecting and controlling compliance with this principle and to detecting involvement in VAT fraud. The success of e-commerce compliance measures is therefore dependent not only on the adoption of instruments that reduce the

[87] Article 31(2) Council Regulation (EU) No 904/2010 of 7 October 2010 on administrative cooperation and combating fraud in the field of value added tax.

[88] MARTINÍK, Pavel. Místo plnění při režimu One Stop Shop [Place of Supply in case of One Stop Shop Regime]. *e-Bulletin Komory daňových poradců České republiky [e-Bulletin of the Chamber of Tax Advisers of the Czech Republic]*, 2021, no. 12, p. 46.

administrative burden of tax administration, but also on the existence of effective supervisory instruments.[89]

E-commerce allows purchases to be made without the physical presence of the buyer and without the existence of a brick-and-mortar store — for example, via a smartphone or computer. The vast majority of such purchases are then paid for through payment service providers (PSPs).[90] These PSPs therefore have a considerable amount of information on the payee, the amount, and the date of payment, and have been obliged to keep records of cross-border payments and payees where, in the course of a calendar quarter, they provide recorded payment services corresponding to more than 25 cross-border payments to the same payee and at least one of those payments meets the statutory conditions for being recorded.[91] Payment service providers are then obliged to provide the data from these records to the tax authorities. This provides the tax administration with comprehensive information on payments between Member States, which may indicate the performance of economic activity, the taxation of which it is subsequently able to control.

The records of cross-border payments add a payment layer to VAT fraud detection. This is analytically different from invoice-based reporting. Control reports and summary reports are based on what taxable persons declare as supplies. Payment data, by contrast, may reveal economic activity even where the supplier has not properly registered, has not issued invoices in the expected manner, or has not declared the transaction in the Member State of consumption.

This makes the instrument particularly important for e-commerce. In cross-border online sales, the seller may be established in another Member State or outside the EU, while the consumption takes place domestically. The Member State of consumption may therefore have limited information about the seller unless the seller complies with VAT registration or OSS/IOSS obligations. Payment service providers occupy a different position. They process the payment flow and may therefore identify repeated cross-border payments to the same payee. The instrument is not designed to monitor the consumer or the purpose of each purchase, but to identify payees whose volume of cross-border payments indicates an economic activity relevant for VAT.

Its primary function is detection. It does not itself assess VAT, deny a deduction, impose liability or secure payment. It supplies information which may then be combined with registration data, OSS/IOSS data, platform information, or tax returns. In the system of instruments, it therefore complements invoice-based reporting by focusing on the money flow rather than the declared transaction.

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89 See the explanatory memorandum to Act No. 417/2023 Coll., amending Act No. 235/2004 Coll., on value added tax, as amended, and other related acts, p. 7.

90 VONDRAŠ, PANTŮČEK, ibid., p. 669.

91 See section 110zzc VAT Act.

4.2.4 Reporting obligations under the Act on International Cooperation

As European integration deepens, barriers to trade between Member States fall away. At the same time, the availability of cross-border transactions has increased for both businesses and consumers. As a result, Member States need a higher degree of cooperation to address the adverse effects of globalisation in tax administration.[92] To this end, Council Directive 2011/16/EU of 15 February 2011 on administrative cooperation in the field of taxation and repealing Directive 77/799/EEC was adopted at the level of the EU, and is gradually being supplemented with other forms of cooperation between Member States in the administration of taxes, which generally consist in the automatic exchange of information on various types of activities, which are typically subject to VAT or income tax.

International cooperation is mainly concentrated in three forms:[93]

- exchange of information on request,
- automatic exchange of information,
- self-initiated exchanges of information.

The exchange of information on request consists of a tax authority requesting specific information from another Member State. In contrast, a spontaneous exchange of information involves the transfer of information to the tax authority in another Member State on the assumption that it can use that information in tax administration. Automatic exchange of information then consists of a regular bulk exchange of information of a certain type without individual impulse.[94]

The reporting obligation in the area of international cooperation in tax administration is thus understood as the obligation of persons participating in tax administration to report information to the tax authority for the purposes of the automatic exchange of information. Currently, information is exchanged in the following areas:

- automatic exchange of information by type of income and assets, essentially sharing information relating to persons or unincorporated entities subject to tax in another Member State;[95]
- automatic exchange of information reported by financial institutions, where information on financial accounts with financial institutions is reported;[96]

[92] Explanatory Memorandum to Act No. 164/2013 Coll., on International Cooperation in Tax Administration and on Amendments to Other Related Acts, p. 17.

[93] Section 1(2) Act on International Cooperation.

[94] Section 1. In: TULÁČEK, Michal. Zákon o mezinárodní spolupráci při správě daní. Komentář [International Cooperation in Tax Administration Act. Commentary]. *ASPI* [online]. Wolters Kluwer. Available in ASPI.

[95] Section 13 Act on International Cooperation.

[96] Sections 13a to 13ta Act on International Cooperation Act.

- automatic exchange of information notified by multinational enterprise groups (CbCR) containing aggregated information on the multinational enterprise group and its entities in each Member State;[97]
- automatic exchange of information by intermediaries of cross-border arrangements, the aim of which is to share information on cross-border arrangements which have the effect of, inter alia, obtaining a tax advantage, avoiding reporting obligations, and concealing the beneficial owner;[98]
- automatic exchange of information reported by platform operators aimed at sharing information on transactions from online marketplaces, auction portals and brokerage portals.[99]

Within these defined categories, the obliged persons must report the specified data to the domestic tax authorities[100] which will then arrange the automatic transmission thereof to other countries.

4.2.5 Digital reporting and the future of detection instruments

The development of EU VAT law confirms that reporting obligations are becoming a central anti-fraud instrument. The VAT in the Digital Age package moves the common VAT system towards real-time digital reporting based on electronic invoicing for cross-border B2B transactions. This does not replace the substantive rules on deduction, exemption or liability. It changes the informational environment in which those rules are applied.

For the Czech system, this development is important for two reasons. First, domestic instruments such as control reports already represent a data-based model of VAT administration. ViDA therefore does not introduce an entirely new logic but reinforces and Europeanises it. Secondly, harmonised digital reporting may reduce one of the weaknesses of purely national reporting systems because reconstructing cross-border chains with comparable speed and detail across all relevant Member States is inherently difficult.

The analytical point is that digitalisation does not remove the need for restorative or retributive instruments. Even perfect reporting does not itself decide whether a supply was genuine, whether the VAT payer knew or should have known of fraud, or whether a security order is proportionate. It only changes the timing and quality of information available to the tax administration. Digital reporting therefore

[97] Sections 13za to 13zq Act on International Cooperation.
[98] Sections 14 to 14s Act on International Cooperation.
[99] Sections 14t to 14zzx Act on International Cooperation.
[100] The automatic exchange of information is managed by the Specialized Tax Office (Section 8a(1) Act on International Cooperation).

strengthens the detection function of the system, but it must still be connected to procedural guarantees and to the substantive limits developed in VAT case law.

4.3 Search activity and supervisory procedures

In order to achieve the purpose of tax administration, i.e., the correct determination and assessment of tax and to ensure its payment, the Tax Procedure Code defines specific procedures to help ensure, in particular, the correctness of the determination and assessment of tax. These are the search and supervisory procedures in tax administration. These procedures make it possible to verify whether a taxpayer is properly complying with its tax obligations both in terms of assessment and payment.[101]

The search activity is the use of technical, legal, and organisational means to establish the facts relevant for the tax administration without the taxpayer's knowledge. In this activity, the tax authority, for example, requests and uses information from records, registers, or information systems. In addition, it obtains information from specific persons (through the submission of explanations) or about a specific place (through local investigations).[102] Such search and processing of information is not dependent on the existence of a specific procedure or formalised process but rather typically precedes it (although it may also take place during such procedure/process). The "covert" exercise of search activity thus allows the objective of tax administration from being compromised, while limiting the tax administration's intervention to taxpayers where incorrect tax assessment and determination can reasonably be expected. This leads to a targeting of supervisory procedures.[103]

The search activity itself does not lead to the determination of tax, but to the verification of the correctness of the claims made by taxpayers and the search for evidence. Its goal is therefore not to evaluate the evidence and draw (final) conclusions on the facts;[104] that is the purpose of the evidence during the proceedings.[105]

For the purposes of checking the correctness of the tax assessed, the primary supervisory procedures are used. These are formalised tax administration procedures, i.e., procedures that have a formal beginning and end and, where appropriate, a more specific course of action. The Tax Procedure Code considers the supervisory procedures to be the tax audit and the procedure for the removal of doubts.

A tax audit serves to comprehensively examine the tax liability, the taxpayer's declarations, and other circumstances relevant to the correct determination and

[101] BAXA, Josef, et al. *Daňový řád. Komentář. I. díl [Tax Procedure Code. Commentary. Volume 1]*. Praha: Wolters Kluwer, 2011, p. 420.
[102] Explanatory memorandum to Tax Procedure Code, p. 57.
[103] LICHNOVSKÝ, ONDRÝSEK, et al., ibid., p. 328.
[104] Judgement of the Supreme Administrative Court of 15 March 2022, Afs 39/2020-29.
[105] BAXA, et al., *Volume 1.*, ibid., p. 421.

assessment of tax relating to a single tax procedure. It thus has a specific subject matter in the form of a tax and a tax period and, where appropriate, a scope limited by the subject matter.[106] However, if the tax administration has specific doubts as to the accuracy, conclusiveness, or completeness of a tax claim or other document submitted by the taxpayer, or the truth of the information provided, it has at its disposal, as a more appropriate tool, a procedure for the removal of doubts. The latter, as the name implies, serves to remove doubts held by the tax administration.[107]

Since the search activities and supervisory procedures are very complex tools, I do not consider it useful to discuss them in detail in this book. However, I consider it essential to mention that they are key procedural tools for verifying the correctness of the fact-finding stage of tax administration and, therefore, for verifying the tax liability affected by tax fraud. In particular, the search activity is closely linked to the reporting obligation, since it is the search activity that allows the information obtained to be processed and to make a preliminary judgment on the basis of that information about incorrect tax assessment or non-standard conduct of taxpayers, which may indicate, for example, fraudulent conduct to the detriment of the fiscus.

The relationship between reporting obligations and supervisory procedures can be described as a transition from risk signal to procedural evidence. Data obtained from control reports, summary reports, CESOP or international cooperation may indicate a risk, but they do not automatically establish that VAT fraud occurred. The tax authority must transform the signal into procedurally usable findings. This transformation takes place through search activities, the procedure for the removal of doubts, tax audit, local investigation and requests for information.

This distinction is important for the protection of taxable persons. A data mismatch may be caused by fraud, but also by timing differences, incorrect reporting, a mistake in the VAT identification number, or a legitimate difference in legal classification. Therefore, the tax administration should not treat detection instruments as substitutes for proof. Their role is to select and structure further verification. The more serious the legal consequence for the taxpayer, especially denial of deduction or liability for unpaid tax, the stronger the need to establish the relevant factual and subjective elements in a formal procedure.

Search activity and supervisory procedures are therefore detection instruments in a procedural sense. They do not merely collect information; they connect data-based risk analysis with legally reviewable tax administration.

[106] Judgement of the Supreme Administrative Court of 17 October 2018, 9 Afs 337/2018-43.
[107] Judgement of the Supreme Administrative Court of 25 June 2014, 1 Aps 20/2013-61.

4.4 Institute of unreliable payer and unreliable person

Act No. 502/2012 Coll., amending Act No. 235/2004 Coll., on value added tax, as amended, and other related acts, introduced the status of an unreliable VAT payer into the Czech VAT system. Its introduction was related to the practical problems of cancelling the registration of a VAT payer *ex officio* — if a VAT payer's registration was cancelled (typically for non-compliance with the obligations arising from the VAT Act) and the taxable person still met the turnover condition, the taxable person would in principle have to be re-registered immediately after the cancellation. The tax authorities would thus have very limited possibilities to eliminate illegal activities by cancelling the registration.[108]

4.4.1 Unreliable payer

In order to be granted the status of an unreliable payer, both substantive and procedural conditions must be met. The substantive prerequisite for declaring a VAT payer unreliable is a serious breach of its obligations related to the administration of VAT. From the point of view of procedural conditions, the existence of a decision of the tax administrator by which the VAT payer is declared unreliable is necessary. Therefore, a VAT payer does not become an unreliable payer automatically upon fulfilment of specific conditions, but only *ex nunc* from the entry into force of the decision on the unreliable payer.[109]

The application of the status of unreliable payer is primarily dependent on the interpretation of the concept of "serious breach of obligations related to VAT administration", i.e., the definition of criteria, conditions, or categories of situations that reach such a level of seriousness that may lead to the issuance of a decision on an unreliable payer. In order to unify the application of this practice, the General Financial Directorate issued a notice on the application of section 106a VAT Act and related provisions.[110] It defines typical situations, which can be summarised in general terms as a threat to the public interest in the proper collection of VAT, in which:

[108] Explanatory memorandum to Act No. 502/2012 Coll., amending Act No. 235/2004 Coll., on Value Added Tax, as amended, and other related acts.

[109] For reasons of special consideration, the tax authority may then exclude the suspensive effect and the VAT payer becomes unreliable at the moment of delivery of the decision (see section 106a(3) VAT Act).

[110] Informace GFŘ k aplikaci § 106a zákona č. 235/2004 Sb., o dani z přidané hodnoty, ve znění pozdějších předpisů (nespolehlivý plátce), a souvisejících ustanovení [Information of the General Financial Directorate on the application of section 106a of Act No. 235/2004 Coll., on Value Added Tax, as amended (unreliable payer), and related provisions]. *financnisprava.gov.cz* [online]. Available at: https://financnisprava.gov.cz/assets/cs/prilohy/d-seznam-dani/2017_Info_NESPP-ve-zneni-dodatku4.pdf

a) the tax is assessed using assessment aids, with a minimum additional tax assessment of CZK 500,000;
b) the VAT payer has engaged in transactions for which there is a reasonable apprehension that VAT will not be paid and therefore the tax authority has issued a security order;
c) the VAT payer has been in cumulative VAT arrears of at least CZK 500,000, excluding accessories, for at least three consecutive calendar months, and this situation is ongoing at the time the decision is issued;
d) the tax is assessed in connection with non-recognition by the VAT payer of a tax deduction claim with a reduction in the claimed tax deduction of at least CZK 500,000, and the related tax is not fully paid within the alternative due date;
e) the tax is repeatedly assessed using assessment aids;
f) the VAT payer does not provide sufficient cooperation in the assessment of the tax, i.e., does not properly respond to the tax authority's request or does not submit the required data necessary for the tax administration without proper justification;
g) the VAT payer hinders or obstructs the VAT administration by repeatedly failing to file a tax return or report or an extract from the register for tax purposes;
h) the VAT payer has provided false or incomplete information when registering for VAT, e.g., the VAT payer has not completed or corrected an already invalid or false registration data concerning its seat despite a request to do so from the tax administrator;
i) the output tax has been determined to be at least CZK 500,000 more than the amount claimed by the VAT payer, and the related tax is not fully paid within the alternative due date.

It follows from the types of situations contained in the notice that this measure may apply not only to tax fraud, as I have defined it earlier, but also to other types of non-performance of VAT obligations — typically to negligent performance of obligations, but also to simple mistakes by VAT payers. It is thus up to the tax authorities to consider the specific circumstances of each VAT payer.

4.4.2 Unreliable person

In addition to the status of unreliable payer, the domestic VAT system includes the institute of an unreliable person. The introduction of this status was caused by the experience with some unreliable payers. They applied for cancellation of their VAT registration in order to re-register after meeting the legal conditions. However, they lost their status of unreliable payer when their registration was cancelled and with the new registration they were again acting as normal (reliable) VAT payers. The VAT Act now regulates this transfer between statuses in two provisions. If an unreliable person becomes a VAT payer, that person simultaneously becomes an unreliable payer.[111] Conversely, if the registration of a VAT payer is cancelled *ex officio* because of a serious breach of obligations relating to VAT administration, or if the registration of an unreliable payer is cancelled, the person becomes an unreliable person at the moment at which it ceases to be a VAT payer.[112] In addition, a person who is not a VAT payer may be declared an unreliable person if it seriously breaches obligations relating to VAT administration.

In order to ensure a uniform application of the concept of "serious breach of obligations related to VAT administration", the General Financial Directorate issued a notice,[113] which elaborates model situations similarly to the information on unreliable payers. These may include:

a) repeated breaches of the identified person's obligations;
b) repeated issuance of a document by a non-VAT payer who issues a document on which it indicates the tax but fails to declare and pay the tax pursuant to section 108(4)(g) VAT Act;
c) the fictitious issue of a tax invoice, i.e., for a transaction that did not actually take place;
d) a final conviction for the commission of a criminal offence of tax, fee, and similar compulsory payment evasion under section 240 Criminal Code in relation to VAT or for the misrepresentation of data on the state of management and assets under section 254 Criminal Code in relation to VAT obligations;
e) engaging in transactions where there is a reasonable apprehension that VAT will not be paid on them and therefore a security order was issued but not fully paid within the time limit;
f) breach of the VAT registration obligation;
g) records of cumulative VAT arrears of at least CZK 50,000 without tax accessories for at least three consecutive calendar months;
h) repeated breach of the obligation to use the new vehicle scheme under section 19(6) VAT Act.

4.4.3 Consequences of being declared an unreliable payer or unreliable person

Designation as an unreliable payer has a direct impact on the tax period of a particular VAT payer. The standard VAT period is the calendar month. However, a taxable

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111 Section 106a(4) VAT Act.

112 Section 106aa(4) VAT Act.

113 Informace GFŘ k aplikaci institutu nespolehlivé osoby a související problematiky podle zákona č. 235/2004 Sb., o dani z přidané hodnoty, ve znění pozdějších předpisů [Information of the General Financial Directorate on the application of the institute of unreliable person and related issues under Act No. 235/2004 Coll., on value added tax, as amended]. *financnisprava.gov.cz* [online]. Available at: https://financnisprava.gov.cz/assets/cs/prilohy/d-seznam-dani/Informace_GFR_k_nespolehlive_osobe_DPH_pro_verejnost_ve_znen-1.pdf

person may decide, subject to the conditions of section 99a(1) VAT Act, that its tax period for the relevant calendar year shall be the calendar quarter. This choice cannot be made by unreliable payers, as they are excluded directly by section 99a(1)(b) VAT Act. Should the VAT payer then have a calendar quarter as its tax period at the time that it becomes an unreliable payer, its tax period will be changed to a calendar month from the following calendar quarter without further delay pursuant to section 99a(4) VAT Act. The reduction of the tax period from a calendar quarter to a calendar month ensures greater control over the VAT payer's activities and obliges the VAT payer to fulfil its obligations in the tax administration in terms of finding and payment in a shorter time interval. The tax administration can thus react more promptly to any further developments in the VAT payer's compliance and enforce tax obligations more promptly.

Designation as an unreliable payer is not only a matter of designating a particular payer as unreliable for the purposes of the tax administration but is also intended to be an indicator of risk to third parties. The information that the VAT payer is an unreliable payer is published in the VAT register. The tax authority publishes, in a manner allowing remote access, the fact that a person is an unreliable payer or an unreliable person.[114] The disclosure is made through the VAT register, which also contains other information about the registered taxable persons, such as name and surname, business name, registered office, and bank accounts.[115],[116] This ensures that third parties are informed of the taxable person's non-compliance with VAT administration obligations.

The unreliable-payer and unreliable-person regimes can be understood as instruments of public risk labelling. The tax administration does not merely record an internal assessment of the taxable person. It communicates that risk to the market. This has two consequences. First, business partners are encouraged to carry out due diligence before entering into transactions. Secondly, the legal and economic consequences of the status may isolate the risky person from ordinary commercial relations.

This mechanism is preventive, but it is not preventive in the same way as reverse charge. Reverse charge prevents a specific tax loss by changing the person who declares the tax. The unreliable-payer regime prevents fraud indirectly, by changing the behaviour of third parties. It encourages them either not to trade with the risky person or to use protective mechanisms, especially the special method of securing the tax. In this respect, the instrument partly outsources VAT risk management to the market.

The same feature also explains why the instrument may be sensitive from the perspective of proportionality. Public designation as unreliable may have serious

[114] See section 106ac(4) VAT Act.

[115] Section 98 VAT Act.

[116] The VAT register is available at: http://adisreg.mfcr.cz/cgi-bin/adis/idph/int_dp_prij.cgi?ZPRAC=FDPHI1&poc_dic=2

reputational and commercial effects even though it is not formally a criminal sanction. Its justification therefore depends on a sufficiently serious breach of VAT-related obligations and on the possibility of legal protection against an incorrect designation.

The publication of unreliable-payer status is relevant for liability under section 109 VAT Act. Under section 109(2)(a), if the provider of a taxable supply, or the recipient of payment for that supply, is published as an unreliable payer, it is presumed that the recipient knew or should and could have known that the tax would intentionally not be paid. This presumption supports the recipient's liability for the supplier's VAT arrears under section 109(1). By contrast, the same mechanism cannot be applied merely because the supplier is an unreliable person, since section 109 operates in relation to taxable supplies between VAT payers.

A separate consequence of unreliable status appears in the rules on the correction of VAT in respect of unpaid supplies. Under the current wording of section 46(3)(c) VAT Act, the correction cannot be made if, no later than on the date of the supply, the creditor knew or should and could have known, having regard to the circumstances of the business relationship and acting with due managerial care, that the taxable supply would not be duly paid. If the debtor was an unreliable payer or an unreliable person on the date of conclusion of the contract, section 46(4)(c) VAT Act creates a statutory presumption that this condition is fulfilled. The correct analysis is therefore based on a rebuttable presumption rather than on an absolute bar linked simply to the debtor's unreliable status.

4.5 Denial of a claim

The denial of a claim under the VAT system is a restorative instrument used where the formal operation of VAT would otherwise protect a result connected with fraud or abuse. It does not operate at the stage of preventing the fraudulent transaction from being created. It operates after the VAT payer has invoked a right within the VAT system, typically the right to deduct input tax or the right to exempt an intra-Community supply with the right to deduct.

It is essential to distinguish denial of a claim from the ordinary failure to prove the conditions of the claim. If the VAT payer does not prove that a supply was received, that the goods were transported to another Member State, or that the supply was used for taxable economic activity, the right does not arise or cannot be exercised. In such a case, the tax authority does not deny an existing right but it concludes that the conditions of the right have not been established. Denial of a claim presupposes a different situation. The substantive and formal conditions may be fulfilled, but recognition of the right would undermine the functioning of the VAT system because the right is connected with fraud or abuse.

The instrument is therefore not a sanction in the criminal-law sense. Its function is to restore the fiscal and normative position which would have existed if the VAT system had not been misused. At the same time, because denial may affect a person other than the direct perpetrator of the fraud, it must be limited by the knowledge test developed in case law — the taxable person must have known or should have known that the transaction was connected with VAT fraud.

The mechanism (at least in relation to the involvement in tax fraud) does not derive from an express statutory provision in domestic or EU legislation and is derived only from judicial practice, which considers it to be part of the interpretation of EU law.[117] In order for a claim to be denied, it is always necessary for the relevant right to arise or for that (subjective) right to be proven.[118] Thus, only an existing right to a tax deduction or exemption can be denied. If the right in question cannot be proven, it cannot be denied.

4.5.1 Tax deduction

The right to deduct input tax is an expression of the principle of VAT neutrality.[119] However, the VAT payer is not entitled to deduct tax on all supplies received, but only on those supplies for which it meets the conditions defined by the VAT Act. These conditions can be divided into substantive and formal conditions.

The substantive condition for the right to deduct tax is the receipt of a taxable supply within the framework of economic activity for the purpose of carrying out the supplies defined in section 72(1) VAT Act. However, the most typical taxable supply is the supply of goods or services with the place of supply in Czechia or exempt supplies with the right to deduct tax with the place of supply in Czechia. This substantive condition is followed by a formal condition defined in section 73(1) VAT Act, consisting in the fact that the VAT payer claiming the deduction has a tax document relating to a specific supply. If these conditions are met, the VAT payer is entitled to the deduction (substantive condition) and is entitled to claim it (formal condition).[120]

[117] CJEU Judgment of 18 December 2014, C-131/13, C-163/13, C-164/13, *Italmoda*.

[118] Judgment of the Supreme Administrative Court of 5 November 2016, 6 Afs 170/2016-30. See BRANDEJS, et al., ibid., p. 731 and following.

[119] BERGER, Wolfgang; KINDL, Caroline; WAKOUNIG, Marian. *Směrnice ES o dani z přidané hodnoty. Praktický komentář [Commentary on the EU VAT Directive. Practical Commentary]*. Translated by Kristýna ŠIMÁČKOVÁ. Praha: 1. VOX, 2010, p. 119.

[120] However, the case law has concluded that, in order to preserve VAT neutrality, the fulfilment of the substantive conditions is decisive. Failure to comply with the formal conditions for deduction cannot in itself lead to the denial of the right to deduct VAT, although it may weaken the taxable person's evidentiary position (see the judgment of the Court of Justice of the European Union of 15 September 2016 in Case C-518/14, *Senatex*, and the judgment of the Court of Justice of the European Union of 15 September 2016 in Case C-516/14, *Barlis 06*). The burden of proving that the conditions for the right to deduct VAT have been fulfilled always rests with the taxable person (see the judgment of the Court of Justice of the European Union of 15 September 2016 in Case C-518/14, *Senatex*, and the judgment of the Court of Justice of the European Union of 15 September 2016 in Case C-516/14, *Barlis 06*).

Even if the substantive and formal conditions are met, the VAT payer may still be denied the right to deduct the tax. This happens in situations where the VAT payer claims the deduction in a fraudulent or abusive manner.[121]

4.5.2 Tax exemption

Exemption from tax with the right to deduct tax is an issue very close to the right to deduct tax. In the case of the supply of goods to another Member State or the export of goods, it ensures the territorial neutrality of VAT,[122] as it allows the goods not to be taxed at the place where they are not ultimately consumed.

The supply of goods to another Member State is therefore exempt from tax under section 64 VAT Act with a right to deduct tax. Thus, the trader retains the tax deduction even though its supply is not subject to any tax at all on the output side. In order to qualify for this exemption, the goods must be supplied by the taxable person to a person registered in another Member State for whom the acquisition of the goods in another Member State is taxable. To these basic conditions, the legislator then adds that:

- the person making the purchase must provide the VAT payer with its tax identification number,
- the goods must have actually been dispatched or transported from the domestic territory to another Member State by the payer, the acquirer, or a third party authorised by the payer or the acquirer; and
- the VAT payer must indicate the supply of the goods in the summary report.

Where those conditions are met, the supply must be exempt in order to preserve neutrality. However, as in the case of a tax deduction, the tax authorities are given the option of denying the claim where the supply has been affected by abusive or fraudulent conduct.[123]

The legislator does not explicitly distinguish between substantive and formal conditions in section 64 VAT Act. However, this distinction is as important in the case of exemptions as in the case of deductions. It is a distinction between two types of conditions. The first consists of conditions whose fulfilment is essential for maintaining the territorial neutrality of the VAT system. The second consists of conditions that serve to demonstrate the fulfilment of substantive legal conditions, although such fulfilment may also be demonstrated by other means, and compliance

[121] Judgment of the Court of Justice of 3 March 2005 in Case C-32/03, *I/S Fini H*. Judgment of the Court of Justice of 14 February 1985 in Case 268/83, *Rompelman*.

[122] ZÍDKOVÁ, 2019, ibid., p. 26.

[123] Judgment of the Court of Justice of the European Union of 6 September 2012 in Case C-273/11, *Mecsek-Gabona*.

with formal conditions alone may not necessarily prove that the substantive legal conditions have in fact been fulfilled.[124]

The same analytical distinction therefore applies to exemption as to deduction. If the substantive conditions of exemption are not established, the exemption does not arise. If those conditions are established, the exemption may still be refused where recognition of the right would protect a transaction connected with VAT fraud or abuse and the knowledge test developed in case law is satisfied.

4.5.3 Abuse of law

The concept of abuse of law is probably one of the most important and most frequently used measures against tax avoidance in the Czech tax law.[125] "The principle of the prohibition of abuse of rights is based on the concept that every subjective right has a purpose or goal pursued by a legal norm (objective law). Indeed, there is no dispute that the rule of law is linked to the idea of the purposefulness of law; thus, legal norms are not ends in themselves but serve to achieve some objectives".[126] The exercise of a subjective right, then, is limited by that very purpose.

The Czech concept of abuse of (subjective) rights[127] is based on the theory formulated by Viktor Knapp, who understands abuse of rights as conduct seemingly permitted by law to achieve an illicit result.[128] This has been the case in tax law since the first application of the prohibition of abuse of law in judicial practice in the decision *Divers I*,[129] in which the Supreme Administrative Court assumes that "the task of law as a social normative system is to ensure the reproduction of society and thus its proper functioning in general." Thus, the law must present its addressees with "rational patterns of behaviour, i.e., patterns which serve to organise social relations in a rational manner. This is an injunction not only for

[124] For example, in the judgment of the Court of Justice of the European Union of 27 September 2012 in Case C-587/10, *Vogtländische Straßen-, Tief- und Rohrleitungsbau GmbH Rodewisch (VSTR)*, the Court held that the communication of the VAT identification number to the supplier is not a substantive condition for exemption, but merely one of the means of proving the status of a taxable person and serves to facilitate tax administration. However, the failure to comply with formal requirements should be supported by a rational justification (see the judgment of the Court of Justice of the European Union of 9 February 2017 in Case C-21/16, Euro Tyre BV).

[125] KAPPEL, Jiří. *Opatření proti vyhýbání se daňovým povinnostem [Measures against the avoidance of tax obligations]*. Praha: C. H. Beck, 2023, p. 6.

[126] KÜHN, Zdeněk. K zákazu zneužití práva [On the prohibition of abuse of law]. *Bulletin Komory daňových poradců České republiky [Bulletin of the Chamber of Tax Advisers of the Czech Republic]*, 2024, no. 2, p. 7.

[127] Abuse always concerns a subjective right, since "objective law, understood as a body of legal rules and legal principles (or other unwritten sources of law), cannot itself be abused." (LAVICKÝ, Petr. Section 8. In LAVICKÝ, Petr, et al. *Občanský zákoník I. Obecná část (§ 1–654) [Civil Code I: General Part (Section 1–654)].* 2th ed. Praha: C. H. Beck, 2020, p. 59.).

[128] KNAPP, Viktor. *Teorie práva [Theory of Law]*. Praha: C. H. Beck, 1995, pp. 184–185.

[129] Judgment of the Supreme Administrative Court of 10 November 2005, 1 Afs 107/2004-48.

the legislator, but also for the addressees of legal norms and the bodies which authoritatively interpret and apply these norms; the meaning of law as such is only served by an interpretation of the text of the legal provision which respects such an ordering of relations in society. An interpretation which, in the presence of several different interpretative alternatives, ignores the rationality of the social order cannot be regarded as correct, and the conclusion it reaches cannot, strictly speaking, be regarded as existing law either, for the reason that it contradicts the fundamental meaning of law. After all, it has always been true that to know the law is not only to know its text, but above all to understand its meaning and operation; the same is true of law itself". Similarly, then, abuse of law has been formulated from the outset in the case law of the CJEU,[130] which implies a two-part test for abuse of law:

- An objective criterion consisting in the formal fulfilment of the conditions of a given legal rule, but not in the fulfilment of its meaning.
- A subjective criterion that examines whether the predominant objective of the conduct is to obtain a tax advantage.

With effect from 1 April 2019, the prohibition of abuse of law is explicitly included in domestic tax law through the principle in section 8(4) Tax Procedure Code, according to which, in tax administration, "no account shall be taken of legal acts and other facts relevant to tax administration, the predominant purpose of which is to obtain a tax advantage contrary to the meaning and purpose of tax law".[131] The consequence of the application of the principle of non-abuse should be "a reconstruction of the facts".[132] Thus, for tax purposes, the tax administration is to base itself on the facts without considering the abusive conduct, i.e., the facts are to be "redefined so as to recreate the situation that would have existed in the absence of the transactions constituting the abusive conduct".[133]

Dissimulation of a legal act, which is contained in section 8(3) Tax Procedure Code, must be distinguished from abuse of law. According to this principle, the tax authority bases its decision on "the actual content of a legal act or other fact relevant to the administration of taxes". Dissimulation can thus be viewed as a situation where the intended conduct is obscured by conduct pursuing a different intention,

[130] Judgment of the Court of Justice of the European Union of 14 December 2000 in Case C-110/99, *Emsland-Stärke*. Judgment of the Court of Justice of the European Communities of 21 February 2006 in Case C-255/02, *Halifax*.

[131] The provision was introduced as a result of the transposition of Article 6 of Council Directive (EU) 2016/1164 of 12 July 2016 laying down rules against tax avoidance practices that directly affect the functioning of the internal market. However, its scope is limited to corporate income taxation. Moreover, for the assessment of the subjective element, it requires the existence of a principal purpose or one of the principal purposes, rather than a predominant purpose.

[132] KAPPEL, ibid., p. 39.

[133] Judgment of the Court of Justice of the European Communities of 21 February 2006 in Case C-255/02, *Halifax*.

or where there is no conformity of expression and will.[134] However, it is only a formal act, precisely because of the inconsistency between the form and the material content.

Case law often does not clearly distinguish between the principle of non-abuse and the principle of non-dissimulation. The absence of the principle prohibiting abuse of law directly in tax legislation has certainly contributed to this development. An explicit statutory expression appeared in the Tax Procedure Code only in 2019, while the entire concept of the prohibition of abuse of law had previously been developed through the case law of both the CJEU and the Supreme Administrative Court. This was also the case for *Divers I*, as a factually similar case (referred to as *Divers II*) was decided by another chamber of the Supreme Administrative Court using the principle of the prohibition of dissimulation (although it reached the same conclusion in fact).[135] Nonetheless, the distinction between these measures has its merits.

In the case of dissimulation, it is not important to examine the purpose of the legal norm in the first place, as it focuses only on examining the expression and will of the parties to the legal transaction. In contrast, in the case of abuse of law, it is necessary to apply the two-part test described in the previous point — the teleological interpretation of the legal norm is then crucial for examining the objective aspect of the misuse of law.

The different nature of these principles is also reflected in the burden of proof. In the case of abuse of law, the tax authority must establish both the objective element, namely the formal fulfilment of the legal rule contrary to its purpose, and the subjective element, namely the predominant aim of obtaining a tax advantage. In the case of dissimulation, the decisive issue is different. The tax authority must establish that the expressed legal act does not correspond to the actual content or will behind it.[136]

Finally, these measures also differ in their consequences. As a result of the application of the principle of the prohibition of abuse of rights, legal acts which have as their predominant objective the acquisition of a tax advantage are disregarded. The situation is reconstructed as if the abuse of law had not taken place, "not only for the taxpayer identified as having abused the right, but also for the other entities affected by the reconstruction, both in the direction of an increase in tax and a reduction in tax".[137] The effect of applying the prohibition against dissimulation is to "see through" the facts and take into account the true nature of the legal action.[138]

[134] Resolution of the Extended Chamber of the Supreme Administrative Court of 3 April 2007, 1 Afs 73/2004-89.

[135] Judgment of the Supreme Administrative Court of 19 January 2006, 7 Afs 115/2004-47.

[136] KAPPEL, ibid., pp. 38 and 39.

[137] NOVÁKOVÁ, Petra; FUKSOVÁ, Jana. Jak (ne)aplikovat zneužití práva v daních [How to (Not) Apply the Abuse of Law Doctrine in Taxation]. *Bulletin Komory daňových poradců České republiky [Bulletin of the Chamber of Tax Advisers of the Czech Republic]*, 2024, no. 2, p. 25.

[138] KAPPEL, ibid., p. 39.

The distinction between these measures also leads to the question whether the right to deduction or exemption is denied at all. Denial can only occur where the subjective aspect of the VAT payer's conduct is at odds with the purpose of the legal rule. In such a case, therefore, for the purposes of triggering the legal consequences of a particular act, we reconstruct the factual situation into a state consistent with the purposes of the legal rule. We are thus denying an otherwise legitimate claim for an abusive exercise of law. In the case of dissimulation, there is no basis for denying the claim, since the dissimulation only affects the factual findings relevant to drawing the consequence of the legal rules.[139] It is thus a question of legally relevant factual findings.

The relevance of abuse of law for this book is therefore limited but important. Abuse of law is not identical with VAT fraud. It is typically directed against arrangements which formally comply with the wording of VAT rules but defeat their purpose, whereas VAT fraud involves fraudulent conduct, concealment, false documents or non-payment of tax in a transaction chain. Nevertheless, both doctrines perform a similar systemic role because they prevent the VAT mechanism from producing legal effects that contradict its purpose. For that reason, abuse of law belongs in the analysis of denial of claims, but it should not be treated as the central instrument against missing trader or carousel fraud. In those cases, the more specific analysis is participation in VAT fraud and the knowledge test.

4.5.4 Participation in tax fraud

Although EU law frequently uses instruments to prevent tax fraud in relation to VAT, it does not define the concept itself, nor does it provide for a direct consequence in the event of participation in fraudulent conduct. The case law has held that a taxable person cannot rely on the right to deduct where it knew or should have known that the transaction on which that right is based was connected with VAT fraud. The decisive issue is therefore not only whether the taxable person itself committed the fraud, but also whether it participated in a transaction chain affected by fraud with the required level of knowledge.[140] A subsequent decision then formulated a four-part test (the so-called Axel Kittel test) which defines the procedure by which participation in a chain affected by VAT fraud can be assessed:[141]

1. Has there been a tax loss to date?
2. Is this loss the result of fraudulent conduct?

[139] Cf. the judgment of the Court of Justice of 3 March 2005 in Case C-32/03, *I/S Fini H*, and the judgment of the Court of Justice of 14 February 1985 in Case 268/83, *Rompelman*.

[140] Judgment of the Court of Justice of 12 January 2006 in Joined Cases C-354/03, C-355/03 and C-484/03, *Optigen*.

[141] KŘIVÁNEK, Vít; VONDRAŠ, Petr. Zneužití práva v DPH [Abuse of Law in VAT]. *Bulletin Komory daňových poradců České republiky [Bulletin of the Chamber of Tax Advisers of the Czech Republic]*, 2024, no. 2, p. 41.

3. Were the transactions in question linked to this fraudulent conduct?
4. Did the VAT payer know, or should it have known, that it was involved in the fraudulent conduct?

The CJEU reached similar conclusions in relation to tax exemptions.[142] While denial of the right to deduct tax is an interference with the fiscal neutrality of VAT, denial of the right to exemption is an interference with territorial neutrality. Accordingly, the CJEU held that the Directive "precludes the competent authorities of the Member State of supply from imposing an obligation on a supplier who has acted in good faith and has provided evidence which *prima facie* establishes its entitlement to exemption for intra-Community supplies of goods to pay VAT on those goods, where that evidence proves to be false, without that supplier having nevertheless been proved to have been involved in fraud, provided that the supplier has taken all the measures which may reasonably be required of him to ensure that the intra-Community supplies which he makes do not lead him to participate in such fraud".[143]

At first glance, the question may arise whether there is a difference between abuse of law and participating in tax fraud. However, this is an assessment of quite different circumstances and motives. In the case of fraudulent conduct, there will be, in the first instance, fraudulent conduct by one of the parties to the commercial transaction (e.g., the VAT payer fails to include in its tax liability some of the taxable supplies made or reduces its resulting tax liability using a fictitious supply received). Secondly, the form of fault is also different — one can hardly imagine an abusive exercise of law in error or negligence.[144] However, for the purposes of denying the right to deduct tax or the right to exemption, it is sufficient that the VAT payer knew or should and could have known that its transaction was connected with a fraudulent chain; the VAT payer need not itself have intentionally committed the fraud.[145]

For analytical purposes, the denial of deduction or exemption in cases of participation in VAT fraud can be structured into three steps. First, the tax authority must identify VAT fraud in the transaction chain. It is not sufficient to point to irregularities or commercial risk but there must be a tax loss or an attempted tax advantage connected with fraudulent conduct. Secondly, the tax authority must establish a link between that fraud and the transaction in respect of which the taxable person claims deduction or exemption. The VAT payer need not be the missing trader, but the claimed right must be connected with the fraudulent chain. Thirdly, the tax authority

[142] BRYCHTA, Karel, KUPČÍK, Petr, PROCHÁZKA, Vojtěch. Pojmové znaky podvodu na DPH v judikatuře Soudního dvora Evropské unie [Conceptual Elements of VAT Fraud in the Case Law of the Court of Justice of the European Union]. *Časopis pro právní vědu a praxi [Journal of Jurisprudence and Legal Practice]*. Brno: Masarykova univerzita, 2021, no. 3, p. 640.
[143] Judgment of the Court of Justice of 27 September 2007 in Case C-409/04, *Teleos*.
[144] KŘIVÁNEK, VONDRAŠ, ibid., p. 42.
[145] Judgment of the Court of Justice of 12 January 2006 in Joined Cases C-354/03, C-355/03 and C-484/03, *Optigen*.

must examine the VAT payer's knowledge. The right may be denied where the taxable person knew or, having regard to the objective circumstances, should have known that the transaction was connected with VAT fraud.

This structure is useful because it separates the existence of fraud from the VAT payer's participation in it. A fraudulent chain may exist without every participant being deprived of VAT rights. Conversely, a formally correct invoice or transport document does not protect a taxable person who knew or should have known that it was participating in a fraudulent chain. The instrument thus places a due-diligence burden on VAT payers, but this burden is not unlimited. It must remain connected to objective indicators of fraud and to what could reasonably be expected from the taxable person in the circumstances of the transaction.

4.6 Ex officio cancellation of registration

Under the current wording of section 106 VAT Act, *ex officio* cancellation of VAT registration for a serious breach of obligations relating to VAT administration is regulated in section 106(3)(a). The tax authority cancels the registration *ex officio* if the VAT payer seriously breaches its obligations relating to VAT administration and one of the following conditions is met:

a) the VAT payer has no seat in Czechia, became a payer under section 6c VAT Act, and has not made any taxable supply during the three immediately preceding consecutive calendar months;
b) in the case of another VAT payer, its turnover in Czechia for the immediately preceding calendar year did not exceed the amount under section 6(1) VAT Act; or
c) the VAT payer is a VAT group.

The purpose of *ex officio* cancellation is to exclude persons whose continued VAT-payer status would distort or endanger the proper functioning of VAT administration. It should not be understood as a sanction in the strict sense. Its primary function is protective and preventive as it removes from the VAT system persons whose inactivity, serious non-compliance or statutory position makes their continued registration incompatible with the proper assessment and collection of VAT. This also explains its relationship with the unreliable-payer and unreliable-person regimes. Where cancellation is not possible or would not be sufficient, public risk labelling may indirectly isolate the risky person from ordinary commercial relations.

4.7 Securing the tax

Securing instruments differ from denial of deduction or exemption. Denial determines whether a claim under the VAT system should be recognised at all. Securing instruments, by contrast, focus on the risk that an existing or expected tax liability will not be paid. They are therefore concerned primarily with payment risk. In VAT fraud, this distinction is crucial. The public budget may be endangered not only because a taxable person claims an unjustified deduction, but also because tax has been properly assessed or is likely to be assessed but the person liable to pay it will disappear, transfer assets, become insolvent or otherwise frustrate collection.

The restorative function of securing instruments is therefore prospective. They seek to preserve assets or create an additional source of payment before the tax loss becomes irreversible. This explains why they often interfere strongly with property rights even before the final determination of tax. Their legitimacy depends on the existence of a sufficiently concrete risk, the proportionality of the measure and the availability of procedural review.

In the system of instruments, securing mechanisms are located between detection and enforcement. They are usually triggered by information obtained through reporting obligations, search activities or supervisory procedures, but their purpose is not merely to obtain more information. Their purpose is to make later collection possible.

4.7.1 Security order

A security order is a decision within the framework of the so-called securing of payment of an assessed but unpaid tax or tax not yet assessed. It is a precautionary decision of a non-meritorious nature[146] — it is based on a purely hypothetical consideration of whether there is a reasonable apprehension that a tax already assessed but not yet due or not yet assessed will be uncollectible at the time of its enforcement. Although it is an interlocutory decision, it constitutes a serious interference with the subjective rights of a particular VAT payer.

The essence of the security order is the obligation to deposit a security in the form of payment of the amount specified in the security order to the deposit account[147] within 3 working days. However, in justified cases, the security order may be executed as soon as the taxpayer is notified.[148]

The justification of the security order places considerable demands on the tax authority, as it must convincingly state the fulfilment of all conditions for its issuance,

[146] BAXA, Josef, et al. *Daňový řád. Komentář. II. díl [Tax Procedure Code: Commentary. Volume II]*. Praha: Wolters Kluwer, 2011, pp. 1017 and 1018.
[147] Section 167(2) Tax Procedure Code.
[148] Section 167(3) Tax Procedure Code.

and these statements must be based on the tax authority's specific findings supported by the case file.

4.7.2 Lien

Another option to increase the probability of satisfying a tax claim is to establish a lien on the taxpayer's property. This lien is again established by a decision, but, unlike a security order, it cannot be established to secure a tax that has not yet been determined. It must be a tax that has already been assessed but not paid. It is a right *in rem* over another's property to which the rules of private law apply. It is thus not an instrument which would itself change the ownership relations to the pledged values, so that the owner can dispose of them in the normal way (e.g., by giving them to a third party for use, taking benefits from them).[149] This fulfils two functions. First, there is a security function, as pressure is created on the debtor to fulfil its debt. Second, it is a reimbursement function, as the tax authority has the possibility to satisfy the tax claim by monetising the collateral.[150]

If the tax obligation is not fulfilled voluntarily, the tax authority is entitled to enforce the lien. In view of the subsidiary regulation of the lien in private law, the provisions of sections 1359 to 1370 Civil Code apply in particular to the enforcement of the lien.[151]

4.7.3 Liability for unpaid tax

In addition to the law of pledge, another traditional security institution with a derivation from private law is the guarantee. This is a legal relationship between the creditor and the guarantor, the subject of which is the guarantor's obligation to satisfy the creditor's claim if the debtor fails to fulfil the debt. It is by its nature an accessory relationship, as it joins the main relationship between the debtor and the creditor and shares its fate. However, the guarantor is not obliged to pay the debt for the debtor unless its subsidiary obligation comes into existence. The guarantor is therefore a substitute debtor who covers for the debtor if the latter fails to fulfil its debt.

The Tax Procedure Code provides for the existence of two forms of guarantee, namely statutory[152] and quasi-contractual.[153] Quasi-contractual liability requires a written guarantee or a bank guarantee — it is therefore characterised by volun-

149 BAXA, Josef, et al., *Volume II*, ibid., p. 1030.
150 BAXA, Josef, et al., *Volume II*, ibid., p. 1030.
151 Section 170a(1) Tax Procedure Code.
152 Section 171 Tax Procedure Code.
153 Section 173 Tax Procedure Code.

tariness and is not a tool that can be used to combat VAT fraud. The VAT system does not, for example, require the issuing of a guarantee for tax registration.[154] The situation is different for statutory guarantees, which are also useful in combating VAT fraud.

The Tax Procedure Code itself does not define specific categories of situations for the creation of guarantor's liability, but assumes the existence of a legal norm in another law. The VAT Act provides for three situations of liability:

- liability of an authorised consignee,[155]
- liability of the recipient of the taxable supply,[156]
- liability connected with the supply of goods to the operator of the electronic interface[157] and related mechanism.[158]

Under section 109(1), a VAT payer acting as a taxable person that receives a taxable supply with the place of supply in Czechia from another VAT payer, or provides consideration for such a supply, is liable for the supplier's VAT arrears if, at the relevant time, it knew or should and could have known that the tax on the supply would not be intentionally paid. If the duty to declare tax arises upon the taxable supply, the recipient is also liable where this knowledge existed at the time of payment.

Section 109(2) then defines situations in which that knowledge is presumed. Presumptions arise in particular where the supplier is published as an unreliable payer, the transaction is between related persons within the meaning of section 36a(3), the consideration is clearly and without economic justification different from the normal price, the payment is made to an account other than the supplier's published account, the consideration is provided by a virtual asset, the cash part of the consideration exceeds the statutory cash payment limit, or, in fuel supplies, the supplier is not published as a registered fuel distributor.

An authorised consignee is a person as defined in section 3(1)(h) Excise Act. It means a legal or natural person who is not the operator of a tax warehouse at the place where, in the course of its business, it receives, on a one-off or repeated basis, selected products under a duty suspension arrangement transported from another Member State under a licence. Where the acquisition and resale of the selected products from another Member State takes place through an authorised consignee, that authorised consignee is liable for the tax to be declared and paid by the person who used the authorised consignee for the acquisition and resale. The specific feature of this liability is that the guarantor is a person outside the distribution chain.[159] It is the person who holds the authorisation to transport the products selected under

[154] However, it serves the function of securing the tax liability and the financial stability of the taxable person, for example in the case of excise duties or gambling tax.
[155] Section 108 VAT Act.
[156] Section 109 VAT Act.
[157] Sections 109aa and 109ab VAT Act.
[158] Section 109ab VAT Act.
[159] BRANDEJS, et al., ibid., p. 1088.

the excise duty suspension scheme. However, it is not authorised to store or dispatch those products. When the authorised consignee receives the products, they are put into free circulation for excise duty purposes and, consequently, the obligation to declare and pay excise duty on those selected products arises. The person for whom the transport of the selected products under the excise duty suspension scheme has been arranged is then obliged to declare and pay VAT on the domestic supply. If it fails to do so, the authorised consignee is liable for the VAT not paid.

The VAT Act contains a ground for release from liability for the potentially liable person, namely, where it proves that it has taken all measures which may reasonably be required of it to ascertain that the tax will be duly paid by the person who acquired the goods collected. At the same time, it may make use of a special method of securing the tax, i.e., pay the tax on behalf of the person liable to declare and pay the tax in accordance with the procedure laid down in section 109a VAT Act.

The liability of the recipient of a taxable supply performs two functions. In its narrow restorative function, it provides the tax administration with another person from whom unpaid VAT may be collected. In its broader preventive function, it changes the incentives of recipients. A taxable person who knows that payment to an unpublished bank account, an economically unjustified price, payment by virtual asset, or trade with an unreliable payer may trigger liability has a reason to verify its counterparty and the payment structure before the transaction is carried out.

This mechanism is stricter than ordinary private-law liability. The recipient may be exposed to VAT liability even though it has already paid the full contractual price to the supplier. For that reason, the special method of securing the tax under section 109a VAT Act is an important counterbalance. It allows the recipient to eliminate or reduce the risk by paying the VAT component directly to the tax authority on behalf of the supplier. The system therefore does not merely punish insufficient diligence. It also offers a legally structured method by which a cautious taxable person can manage the risk created by the supplier's unreliability or by suspicious payment circumstances.

Another situation of liability is related to the status of unreliable payer. If the information that the VAT payer is an unreliable payer is published in the VAT register at the time of the supply or payment, the recipient of the taxable supply from the unreliable payer is liable for the unpaid tax on the taxable supply received. It is not necessary to examine the fulfilment of any special legal conditions.[160]

The last group of situations in which a guarantee may arise is related to the delivery of fuels. It applies only to domestic deliveries of fuels by their distributors as defined in Act No. 311/2006 Coll., on fuels and fuel filling stations and on amendments to certain related acts (the Fuels Act), as amended. It follows from the definition that a distributor is, in principle, any person who sells fuel in Czechia (regardless of whether it is authorised to do so or not). However, the legislator excludes certain specific persons from this set — among others, petrol stations and

[160] BRANDEJS, et al., ibid., pp. 1095–1097.

recharging stations. Therefore, if fuel is bought at a petrol station, no guarantee can arise. In contrast, liability may arise in the relationship between the fuel supplier and the petrol station. It is relatively easy to avoid such liability, as liability arises only if the distributor is not registered in the register of fuel distributors.[161]

Act No. 355/2021 Coll., amending Act No. 235/2004 Coll., on Value Added Tax, as amended, and Act No. 242/2016 Coll., Customs Act, as amended, added, with effect from 1 October 2021, an additional situation in which liability may arise, namely when goods are supplied to an operator of an electronic interface within the meaning of section 13a VAT Act. It follows that the supply of imported goods at a distance facilitated by an operator of an electronic interface to a non-EU taxable person is considered as two supplies, namely:

- supply of the goods to the operator of the electronic interface, and
- supply of the goods by the operator of the electronic interface to the customer.

The situation is similar for supplies where the operator of the electronic interface facilitates the supply of goods from a foreign person to a non-taxable person from the EU. This electronic-interface operator is not the actual supplier (it is not the owner of the goods), but only an intermediary and, from the customer's point of view, a deemed supplier, since the transfer of ownership takes place between the supplier and the customer (not between the e-interface operator and the customer). However, according to section 13a VAT Act, it is the operator of the electronic interface who is obliged to declare and pay the tax on the importation or supply to the customer (non-taxable person). Thus, although the default tax regime does not follow the private law regime of ownership, there is a close relationship between the individual transactions. Thus, in the event of non-compliance with tax obligations by the operator of the electronic interface, the actual seller may incur liability for unpaid tax.[162] More precisely, under section 109aa VAT Act, the taxable person that supplies goods to the electronic-interface operator under section 13a is liable for the operator's VAT arrears if, no later than on the date of the taxable supply, it knew or should and could have known that the tax on the supply would not be intentionally paid by the operator. This liability may also be addressed through the special method of securing the tax under section 109a VAT Act.

In addition to the situations of liability provided for directly in the VAT Act, however, the existence of other statutory guarantees may be admitted. Probably the most important in this respect will be the possible existence of liability regulated in Act No. 90/2012 Coll., on Commercial Companies and Cooperatives (Act on Commercial Corporations), as amended,[163] and Civil Code. The latter provision is prob-

[161] It is available on the website of the Customs Administration of the Czech Republic: https://celnisprava.gov.cz/cz/aplikace/Stranky/SpdInternet.aspx?act=findphm

[162] Cf. the explanatory memorandum to Act No. 355/2021 Coll., amending Act No. 235/2004 Coll., on Value Added Tax, as amended, and Act No. 242/2016 Coll., the Customs Act, as amended, p. 74.

[163] Examples include the liability of a disqualified member of a statutory body under Section 65 or the liability of an influential person under Section 71(3).

ably the most important in this respect, as it establishes the liability of a member of an elected body for the debt of a legal entity in the event that such member fails to compensate the legal entity for damage caused by a breach of duty in the performance of the member's duties, although the member was obliged to compensate for such damage.[164] The application of such liability, however, places considerable demands on the tax authority, as it must prove that the conditions for the liability contained in the private law norm (typically a breach of the duty of care or other obligation giving rise to liability, depending on the specific legal norm) have been met.[165]

4.7.4 Special method of securing the tax

Individual situations of liability may constitute a significant interference in the sphere of the guarantor, who typically has duly fulfilled its private-law obligation (to pay the consideration) towards the person obliged to declare and pay the tax. Therefore, the VAT Act gives potential guarantors the possibility to use the so-called special method of securing the tax, where they pay the relevant tax to the deposit account of the tax authority on behalf of the person obliged to declare and pay the tax. On the tax due date, the relevant amount is then transferred to the tax account of the person liable to declare and pay the tax with the date of payment on the tax due date or the date on which the payment of the security was made (if the payment was made later than the tax due date).[166] The special method is also expressly available to an authorised consignee and to a taxable person that supplied goods to an electronic-interface operator in situations covered by sections 109a(6) and 109aa(3) VAT Act.

4.8 Instruments under anti-money laundering law

AML law is a relatively young body of law but has become increasingly important in recent years. The scope of this law and the categories of persons who have special legal obligations in the fight against money laundering and terrorist financing are

164 Section 159(3) Civil Code.

165 The issue of the liability of a member of an elected body of a legal entity for the tax debt of that legal entity is also addressed, for example, in the methodological guidance of the General Financial Directorate concerning the judgment of the Supreme Court No. 27 Cdo 59/2022-313 of 30 June 2022 on the issue of the maturity of a damages claim as a condition for the liability of a member of an elected body of a legal entity: https://financnisprava.gov.cz/assets/cs/prilohy/d-jine/71844_22_Info_ruceni-clena-voleneho-organu-PO.pdf

166 Section 109a(4) VAT Act.

thus expanding. The theory of financial law classifies it as one of the specific areas of financial law.[167] It is an area that is closely related to criminal law, as it "aims to support the fight against the commission of crime as such, which takes place primarily within the framework of criminal law".[168] This fight is carried out, inter alia, through selected private-law actors (the so-called obliged persons[169]), who are subject to specific rights and obligations in the area of obtaining information about their business partners, the content of the business relationships they enter into and the origin of the funds they receive, and restrictions on the establishment of risky business relationships. The idea is thus based on ensuring that crime is made less attractive by preventing offenders from using the proceeds of crime.[170]

The obligations of obliged persons include the identification of suspicious transactions, which section 6 AML Act defines as transactions carried out in circumstances giving rise to suspicion of an attempt to launder the proceeds of crime or suspicion that the funds used in the transaction are intended to finance terrorism, or that the transaction is otherwise related to or connected with the financing of terrorism, or any other fact that could indicate such suspicion. It is thus incumbent on obliged persons to be alert to indicators that might suggest an effort to launder the proceeds of crime. If an obliged person becomes aware of a suspicious transaction in connection with its activities, it is under an obligation to report it.[171] If there is then a risk of frustrating or substantially impeding the seizure of proceeds of crime or terrorist financing, the obliged person may delay the execution of the customer's order (e.g., a bank delays the execution of a payment order that it identifies as suspicious) or seize other property to which the subject of the transaction relates (e.g., not to hand over documents arising from the transaction or a stored item). This is typically reported to the Financial Analysis Office, which may subsequently extend the period of suspension of the order or seize the property that is to be the subject of the suspicious transaction. This will initially delay the client's order for 24 hours, during which time the Financial Analysis Office may decide to further delay the client's order or seize the property for a further two working days.[172]

The postponement of the client's order or the seizure of other assets allows time for subsequent procedural steps, which may include, for example, a notification to the tax authorities or a criminal complaint to a law enforcement authority. If the Financial Analysis Office files a criminal complaint, it will also inform the obliged person of this fact,[173] which will extend the blocking of funds or seizure of assets by a further three working days. In total, the blocking may last for up to six

[167] KARFÍKOVÁ, Marie, et al. *Teorie finančního práva a finanční vědy [Theory of financial law and financial science]*. Praha: Wolters Kluwer, 2018, p. 78.
[168] KARFÍKOVÁ, et al., 2018, ibid., p. 294.
[169] Section 2 AML Act.
[170] LICHNOVSKÝ, VUČKA, KŘÍSTEK, ibid., p. 257.
[171] Section 18 AML Act.
[172] Section 20(3) AML Act.
[173] Section 20(7) AML Act.

working days after the obliged person has suspended the client's order. The subsequent steps are already in the criminal law regime. If the law enforcement authority does not subsequently proceed to issue a seizure or forfeiture order under the Criminal Procedure Code, the postponement of the client's order or the seizure is terminated by the expiry of the time limit and the client's order can subsequently be implemented.[174]

The complex of these instruments includes the restriction of cash payments pursuant to Act No. 254/2004 Coll., on the restriction of cash payments and amending Act No. 337/1992 Coll., on the administration of taxes and fees, as amended, as amended. The latter determines when persons are obliged to make payments through persons authorised to provide payment services or through a postal service operator in the form of a postal order. Currently, a payment exceeding CZK 270,000 must be made in non-cash form; a cash payment above this limit is also relevant in VAT law as one of the statutory presumptions supporting liability for unpaid tax under section 109 VAT Act. This measure is primarily intended to preserve an electronic trail of cash flows and to ensure that these flows can be monitored. In conjunction with the possibility to suspend the customer's order under the AML Act, this creates the possibility of suspending the transfer of funds. The combination of these two tools is very effective for combating missing trader fraud, as stopping the flow of funds is the "heart of the fraudulent scheme".[175]

Thus, I consider three instruments to be key in the fight against VAT fraud in the context of anti-money laundering law:

- reporting suspicious transactions,
- postponement of a client's order or seizure of other assets,
- restrictions on cash payments.

The specific importance of AML instruments lies in their temporal dimension. VAT fraud, especially missing trader or carousel fraud, is not only a problem of incorrect tax assessment. It is also a problem of speed. The economic benefit of the fraud may be transferred through bank accounts before the tax administration is able to complete assessment or collection procedures. AML law responds to this risk by involving obliged persons who observe financial flows in real time or near real time.

Suspicious transaction reporting therefore has a detection function, while postponement of a client's order or seizure of other assets has a restorative or securing function. The two functions are closely linked. The value of the information lies partly in the possibility of acting before the proceeds of the fraud are moved further. This is why AML instruments are not merely external to VAT administration. They

[174] HYLMAR, Jiří; HLADKÁ, Michaela. Instituty omezení vlastnického práva na základě zákona o AML [Institutes Restricting Property Rights under the AML Act]. *Bankovnictví [Banking]*, 2018, no. 3, p. 19.

[175] LICHNOVSKÝ, VUČKA, KŘÍSTEK, ibid., p. 257.

complement tax-law instruments at the point at which the fraudulent tax advantage is transformed into movable financial value.

At the same time, AML instruments do not determine VAT liability. They do not decide whether deduction should be denied or whether a taxable person is liable under section 109 VAT Act. They preserve the possibility of later tax, criminal or enforcement action. Their role in the system is therefore ancillary but strategically important.

4.9 Criminal liability

A participant in VAT fraud may also commit a criminal offence and thereby incur criminal liability if the conditions prescribed by the law are met. Criminal law thus ensures the protection of the purpose of the existence of taxes, i.e., the protection of "the financing of the State's own activities, its regions and municipalities, as well as the financing of its public functions, in particular those in the social and health spheres".[176]

Several offences may be involved, in particular:

- evasion of tax, fee, and similar compulsory payment pursuant to section 240 Criminal Code;
- failure to pay taxes, social security contributions, and similar mandatory payments pursuant to section 241 Criminal Code;
- failure to comply with the reporting obligation in tax proceedings under section 243 Criminal Code;
- misrepresentation of economic data and assets pursuant to section 254 Criminal Code;
- damage to the financial interests of the European Union under section 260 Criminal Code;
- participation in an organised criminal group pursuant to section 361 Criminal Code.

In addition to criminal liability, a number of procedural tools are important in the fight against VAT fraud. In addition to the tools leading to the detection of offences and their perpetrators, these include tools to ensure the presence of offenders (e.g., summons, order to appear, travel ban, detention, custody)[177] or the obtaining of items necessary for criminal proceedings (e.g., production or surrender of an item,

[176] SOTOLÁŘ, Alexander. Section 240. In: DRAŠTÍK, Antonín; FREMR, Robert; DURDÍK, Tomáš; RŮŽIČKA, Miroslav; SOTOLÁŘ, Alexander. *Trestní zákoník. Komentář. II. díl (§ 233 až 421) [Criminal Code. Commentary. Volume II (Sections 233 to 421)]*. Praha: Wolters Kluwer, 2015, p. 1650.

[177] JELÍNEK, Jiří, et al. *Trestní právo procení [Criminal Procedural Law]*. 7th ed. Praha: Leges, 2023, pp. 350–389.

confiscation of an item, seizure of instruments of crime and proceeds of crime and surrogate value, search of the home and person and search of other premises, and interception and recording of telecommunications).[178]

Criminal liability differs from the tax-law instruments analysed above in both purpose and threshold. Tax-law instruments may operate even where the main objective is to protect the VAT system or the public budget, for example where deduction is denied, tax is secured, or a guarantor is required to pay unpaid VAT. Criminal law requires the fulfilment of the statutory elements of a criminal offence, including the required form of culpability and, where relevant, the statutory threshold of damage.

This distinction is important in VAT fraud cases because the same transaction chain may have different legal consequences for different participants. A taxable person may lose the right to deduct because it should have known that the transaction was connected with fraud, while criminal liability may be imposed only on persons whose conduct fulfils the requirements of criminal law. The tax-law response is therefore broader and more system-protective, whereas the criminal-law response is narrower and more culpability-based.

For that reason, criminal liability is classified as a retributive instrument. It may have preventive effects and criminal procedure may also help detect or secure evidence of VAT fraud. Nevertheless, its primary function is to identify and punish the offender, not to reconstruct the VAT position of a particular tax period.

[178] JELÍNEK, et al., 2023, ibid., pp. 391–407.

5 FUNCTIONAL SYSTEM OF INSTRUMENTS TO COMBAT VAT FRAUD

5.1 Sorting by primary function

The classification of VAT anti-fraud tools can be made according to different criteria. The criterion set out in the introduction to this book is the primary function of the tools. By primary function[179] I mean the purpose to be achieved through the tool. For the sake of clarity, I then divide these purposes as follows:

- fraud prevention (prevention function),
- fraud detection (detection function),
- restoring the state of affairs that was disturbed by the fraud (restorative function),
- punishment (retributive function).

The goal of fraud prevention is to ensure that fraud does not occur at all — that is, to fulfil a preventive function. This can be done through tools that eliminate risky behaviour or tools that are designed to deter a particular person from engaging in risky behaviour.

Fraud detection concerns the identification of risky behaviour and its participants. This is achieved in particular by balancing the information asymmetry, where the relevant authority obtains relevant information, evaluates it and subsequently makes a judgment on the (non-)existence of fraudulent activity. This is the detection function.

By restoring a state that has been disturbed, a restorative function is achieved. It is a focus on remedying the consequences of the harmful conduct, ideally by reconstructing the state as it would have been without the fraudulent conduct. Closely related to this restoration is the requirement to compensate for the loss suffered, which in the case of tax fraud is represented by compensation for the tax lost to the fiscus or the seizure of the funds or other values affected by the tax fraud.

By punishing the wrongdoers, I mean protecting public interests through punishment in the regime of criminal or administrative punishment. This achieves the

[179] The term “function” may be defined as “a sphere of activity or orientation towards a particular purpose.” (Cf. KRAUS, Jiří, et al. *Nový akademický slovník cizích slov [New Academic Dictionary of Foreign Words]*. Praha: Academia, 2007, p. 264.).

general function of criminal repression: protective, repressive, preventive, and regulatory.[180]

The classification is based on primary function. Each instrument is therefore assigned to the function that best explains its legal design and practical role. This does not exclude secondary effects as it only prevents the classification from becoming analytically indeterminate.

The reverse charge consists in the transfer of a partial obligation of the taxable person (i.e., not a change of the tax subject) in relation to the declaration and payment of the tax to the tax authority.[181] This makes it an effective tool in the fight against B2B VAT fraud, as it "eliminates the missing trader fraud, since the scheme does not allow the suppliers of taxable supplies to claim a deduction without themselves declaring and paying the input tax".[182] This makes it a fraud prevention tool, as it does not allow for missing tax to arise at that stage of the commercial chain.

Although the cancellation of the VAT payer's registration is a consequence of the VAT payer's unlawful conduct, it cannot be perceived primarily as a sanction. It does not interfere with the VAT payer's sphere by restricting rights (e.g., by imposing a penalty). The *ex officio* cancellation of a VAT payer's registration for a serious breach of an obligation relating to VAT administration is thus an instrument aimed at eliminating an undesirable VAT payer from the VAT system. This leads me to the conclusion that the *ex officio* cancellation of registration is an instrument not of a retributive but of a preventive function.

The situation is similar in the case of an unreliable payer and an unreliable person. The recognition of this status leads to the reluctance of its business partners to carry out individual transactions with that person, as this may entail a risk for them in terms of liability for unpaid tax or (unwitting) involvement in a fraudulent transaction (which may result in reputational risk or the emergence of retributive instruments). However, compared to the cancellation of registration, the punitive nature is undoubtedly more evident, as the designation as an unreliable payer or person affects the reputation of a particular person through the publication of information about the unreliable payer in the publicly accessible register of VAT payers. However, this intervention ultimately leads either to the reluctance of third parties to cooperate with the VAT payer to the extent that such a person drops out of the VAT system altogether (its turnover falls below the statutory turnover threshold, which may lead to the cancellation of the registration *ex officio*, or the activity of the person concerned becomes unsustainable and the person ceases its activity altogether), or third parties start to use a special method of securing the tax pursuant to section 109a VAT Act to eliminate the risk. This again eliminates the risk of fraud itself.

[180] JELÍNEK, et al., 2019, ibid., pp. 28–30.
[181] TERRA, Ben; KAJUS, Julie. *A Guide to the European VAT Directives. Introduction to European VAT*. Amsterdam: IBFD, 2011, p. 1163.
[182] SEJKORA, ibid., p. 156.

Reporting obligations are the central detection layer of the Czech anti-fraud system. In particular, in the case of information obtained from control reports and summary reports, the tax authorities have the possibility to carry out analytical work in the context of tracing relationships between individuals and entire supply chains. However, this tool does not in itself prevent tax fraud, as it provides a picture of transactions that have already taken place. However, it allows the tax authority to identify persons and transactions at risk on which it can focus further procedural steps to detect and prevent the continuation of tax fraud. I do not consider this tool to be a preventive tool either in the sense that it deters those involved in fraud because of the higher risk of detection. Their deterrent effect is therefore secondary. Sophisticated fraudsters may adapt by creating more complex chains, but this does not change the primary function of reporting obligations: they provide the tax administration with data from which risk signals can be generated.

The use of the reporting obligation by the tax authority is very closely linked to the search activity and control procedures in the VAT administration. The search activity is characterised by the use of technical, legal, and organisational means to establish facts relevant for the tax administration even without the knowledge of the VAT payer and without reliance on the existence of a specific procedure. This knowledge can then lead to the targeting of control procedures — whether a procedure for the elimination of doubts or a tax audit — on persons at risk. It is therefore a group of tools with a detection function in relation to VAT fraud. It is already about specific steps aimed at uncovering fraudulent behaviour and, where appropriate, applying a tool with a restorative function.

Another tool for detecting VAT fraud, although not focused exclusively on the commission of tax fraud,[183] is the reporting of suspicious transactions. This instrument occupies a very important position within the anti-money laundering legal system, as it is through it that the notification obligation of the obliged persons towards the State is implemented. Without the obliged persons, the State would not be able to carry out its own monitoring activities. It is thus an instrument very similar to the reporting obligation and therefore a tool for detecting tax fraud.

An important tool for restoring the state that existed before the fraud occurred is the denial of the right to deduct tax or to claim an exemption. This is a situation in which a subjective right to a deduction or exemption has been established and proven, but in the interests of preserving the VAT system it is not desirable to grant such a right procedurally because it has been exercised contrary to the values and purposes of the legal rule. It is thus an instrument with a restorative function, i.e., leading to a return to an equitable legal order.

Securing a tax has several forms within tax law, but they are always linked by an increase in the probability of the actual fulfilment of the tax obligation in terms of payment. It is characteristic of the decision to secure payment for an outstanding or pending tax, a pledge, a guarantee, and a special method of securing a tax

[183] Its purpose is generally to detect activities that may be connected with criminal conduct.

that the transaction has already been or is being carried out. These instruments are then used to secure payment of the tax on those transactions or the tax which those transactions seek to extract to the detriment of the fiscus. They are thus restorative instruments, as they secure the loss incurred in the tax fraud.

The preceding paragraph also applies to the suspension of a client's order or the seizure of other assets under the AML Act. The purpose of these instruments is to reduce the risk that the seizure of the proceeds of crime will be frustrated, thereby again securing funds obtained in the context of tax fraud. Thus, again, it is a restorative tool.

The effectiveness of the suspension of the client's order and the seizure of other assets under the AML Act is also due to the restriction on cash payments, as this enables obliged persons to suspend the client's order and thereby secure the funds affected by the fraudulent activity by enforcing the handling of funds in non-cash form. However, it could also be regarded as a detection tool, since the obligation to transfer funds in a non-cash form entails leaving an electronic trace of each transaction. This ensures that the flow of funds can be monitored and fraudulent chains can be uncovered. However, I consider the link with the postponement of a client's order important for assessing the primary function. The restriction on cash payments increases the probability that significant transfers will pass through traceable payment channels and may therefore become susceptible to monitoring or temporary blocking under AML rules. It does not itself create VAT liability, but it strengthens the practical effectiveness of detection and securing measures.

Finally, the category of criminal law instruments has a particularly retributive function, as it aims to identify perpetrators of unlawful conduct and punish them within the criminal law system. While there are also instruments within this system that aim to detect fraud or restore a benign condition, ultimately the key function is to punish the wrongdoer.

5.2 Interaction and sequencing of instruments

The instruments analysed in this chapter do not operate in isolation. Their systemic importance lies in their sequence. In a typical VAT fraud risk scenario, the first question is whether the legal structure of the transaction allows the tax loss to arise at all. Reverse charge may answer this question preventively by removing the supplier's ability to receive VAT and fail to remit it. Registration-related measures and the unreliable-payer regime may also prevent risk by excluding or isolating persons whose conduct threatens the proper functioning of VAT administration.

If the fraud risk is not prevented, the system depends on detection instruments. Control reports, summary reports, VIES data, cross-border payment records, platform information and other forms of administrative cooperation create different images of the same economic reality. Invoices show declared supplies. Summary reports show cross-border VAT relations. Payment data show financial flows. Search activities and supervisory procedures then transform these data into procedurally usable findings. Detection is therefore not a single act but a process of reconstructing the chain.

Once the chain is reconstructed, the system moves to restorative instruments. The tax authority may deny deduction or exemption if the conditions developed in case law are met. It may secure tax where there is a concrete risk that payment will be frustrated. It may rely on statutory liability where the recipient of the supply knew or should have known of the relevant risk, or where statutory presumptions are fulfilled. AML instruments may preserve funds or other assets before they disappear from the reach of tax or criminal authorities.

Finally, criminal law may operate where the conduct reaches the threshold of criminal liability. Its position in the sequence is not merely chronological. Criminal proceedings may begin before tax assessment is complete and may also support securing of assets. Nevertheless, its primary function remains different from that of tax-law instruments. Tax law reconstructs or protects the fiscal position. Criminal law punishes culpable conduct.

This sequencing shows why the Czech system cannot be reduced to one dominant instrument. Reverse charge is powerful but narrow. Reporting obligations are informational but not self-executing. Denial of claims is effective but depends on proof of fraud and the taxable person's knowledge. Securing instruments protect collection but require proportionality. Criminal law provides repression but cannot replace tax administration. The system works only if these instruments are used cumulatively and with awareness of their different functions.

6 CONCLUSION

At the beginning of this book, four research questions were formulated in order to achieve its central aim: to construct a functional system of instruments used in Czech law to combat VAT fraud. These questions concerned, first, the structural characteristics of VAT which make fraud possible; secondly, the definition of VAT fraud for the purposes of legal analysis; thirdly, the identification and legal location of the relevant Czech instruments; and fourthly, the primary function of those instruments and their interaction within a broader system.

VAT is the taxation of value added, i.e., the part of the value of the goods or services added by the seller to the value of the goods or services purchased. This is expressed in the principle of neutrality, according to which the tax is not accumulated along the supply and consumption chain and "is not a real cost to the individual taxable persons who, when using the goods or services purchased for their taxable economic activity, should always be fully entitled to deduct the tax paid on the input".[184] However, this system of deductions is susceptible to fraud.[185] The susceptibility to fraud is supported by various phenomena — both the length of the individual chains, the time lags between the deduction of input tax and the taxation of output transactions, and the application of the principle of taxation at the place of consumption. Thus, the basic principle of the tax — the principle of neutrality — carries with it a risk of tax evasion. This risk is then embodied both in the fiscal form of neutrality and in its territorial form.

The most important conclusion from this part of the analysis is that VAT fraud is not external to VAT in the same way as non-compliance may be external to some other taxes. It exploits the very legal mechanisms through which VAT achieves neutrality. The right to deduct input tax, the exemption of certain cross-border supplies with the right to deduct, and the allocation of taxation to the place of consumption are not accidental features of the system. They are necessary for VAT to function as a neutral tax on final consumption. At the same time, they create a legal environment in which the State may be required to recognise a deduction or exemption before it is able to verify whether the corresponding output tax has actually been declared and paid elsewhere in the chain.

The fight against VAT fraud therefore cannot be understood only as a matter of stricter enforcement against dishonest persons. It is also a problem of risk allocation. Each anti-fraud instrument determines who bears the risk that one link in the chain will fail: the State, the supplier, the recipient, another taxable person in the chain,

[184] ZÍDKOVÁ, 2019, ibid., p. 26.
[185] SEMERÁD, BARTŮŇKOVÁ, ibid., p. 418.

obliged persons under anti-money-laundering law, or criminal-law authorities. This is why the preservation of neutrality for honest taxable persons and the protection of public revenues are in constant tension. A successful anti-fraud system must reduce the opportunity for fraudulent extraction of VAT without converting VAT into a tax burden for taxable persons who participate in ordinary economic activity.

For the purposes of this book, VAT fraud has been defined as an unlawful act in the administration of VAT by which another person is misled, a mistake is exploited, or material facts relevant to tax administration are concealed, with the consequence that VAT is not correctly determined, assessed or secured for payment. The damage consists in a reduction of public budget revenue, while the benefit may accrue either to the person committing the fraud or to another person in the chain.

This definition is broader than the criminal offence under section 240 Criminal Code, but narrower than all forms of non-compliance. It focuses on fraudulent conduct affecting VAT assessment, deduction, exemption or payment. Typical manifestations include concealment of taxable supplies, deliberate misclassification of supplies, unjustified input tax deduction and, most importantly, missing-trader or carousel fraud.

For the purposes of the systematisation carried out in this book, it is equally important to distinguish between the person who commits the fraudulent act and the taxable person whose VAT position is affected by the fraud. In many cases these persons may be identical. In carousel or missing-trader fraud, however, the fiscal consequence of the fraud may arise at one level of the chain, while the legal dispute concerns deduction or exemption claimed by another person. This distinction explains why tax-law instruments and criminal-law instruments do not operate in the same way. Criminal law focuses on culpable conduct and punishment of the offender. VAT law, by contrast, may protect the functioning of the system by refusing to recognise a deduction or exemption even in relation to a person who did not itself fail to remit the tax, provided that the conditions developed in EU and national case law are met.

This distinction is analytically important because it prevents the conclusion from treating all instruments as if they were directed at the same person and the same moment. Some instruments are directed against the person who creates the tax loss. Others are directed against the person who claims a fiscal advantage from a transaction connected with that loss. Others operate even earlier, by making the chain visible or by preventing risky persons from participating in the system.

In the fight against VAT fraud, it is possible to identify instruments within the VAT system itself, or tax law as a whole, and instruments outside tax law (typically criminal or anti-money laundering law). The instruments identified in the book can be divided into four functional groups. Preventive instruments, such as reverse charge, *ex officio* cancellation of registration and the unreliable-payer or unreliable-person regime, seek to reduce the possibility that the tax loss will arise at all. Detection instruments, including control reports, summary reports, cross-border payment records, reporting obligations under the Act on International Cooperation, search activity, supervisory procedures and suspicious-transaction reports under the AML Act, reduce the information asymmetry between taxable persons and public authorities. Restorative instruments, including denial of deduction or exemption, securing tax, liens, liability for unpaid tax, special methods of securing tax, and selected AML measures, seek to protect or reconstruct the fiscal position after the risk or loss has materialised. Finally, criminal liability is retributive in its primary function, even though criminal proceedings may also support detection and asset securing.

The classification by primary function also shows that the Czech system is sequential. It does not rely on a single decisive instrument. In the first stage, preventive tools either remove the opportunity for the tax loss to arise or exclude high-risk persons from the ordinary functioning of VAT administration. If the risk is not prevented, detection tools become decisive because the tax administration must reconstruct the transaction chain, compare invoice data with declarations and payments, and identify the link between the tax loss and the person claiming a deduction or exemption. Once this link is established, restorative tools determine whether the fiscal consequences of the fraud can be neutralised, for example by denying a claim, securing tax or preserving assets. Criminal law then operates at a different level, because its purpose is not to reconstruct the VAT position of a tax period, but to punish conduct that reaches the threshold of criminal liability.

The systemic character of the Czech model therefore lies not in institutional unity, but in functional complementarity. The instruments are dispersed across several legal regimes, yet they respond to different phases of the same risk. A weakness in one layer cannot be fully compensated by another. Reporting obligations cannot themselves restore tax revenue. Denial of deduction cannot identify fraud without sufficient information. Securing instruments cannot justify interference with property without concrete risk. Criminal law cannot replace the ordinary assessment and collection of VAT. The effectiveness of the system therefore depends on the proportional and coordinated use of instruments whose legal nature and primary function differ.

Criminal law instruments were not analysed in the same level of detail as tax-law instruments because the focus of this book is financial law and the legal design of VAT administration. Nevertheless, criminal law belongs to the system because VAT fraud may exceed the level of a tax-administration problem and become conduct requiring public condemnation and punishment. Its inclusion also shows the limits of tax law. Tax law is capable of reconstructing the fiscal position, denying unjustified claims and securing payment, but it does not express the same degree of retribution as criminal law. Conversely, criminal law cannot replace tax-law instruments because punishment of the offender does not itself determine the VAT position of other participants in the transaction chain.

The aim of the book has therefore been fulfilled not merely by listing individual instruments, but by showing their place in a functional system. The Czech response to VAT fraud is not a single anti-fraud regime contained in one statute. It is a composite legal system built from substantive VAT rules, reporting duties, procedural powers of the tax administration, securing mechanisms, anti-money-laundering obligations and criminal liability. Its coherence is functional rather than formal. The same fraudulent chain may simultaneously raise questions of deduction, exemption, evidence, payment security, suspicious transactions and criminal culpability. The analytical value of the systematisation lies in showing which instrument should answer which question.

The analysis also shows the inherent limit of all anti-fraud instruments within the existing VAT model. They address risks created by the same mechanisms that make VAT neutral. As long as the system is based on staged collection, input tax deduction and exemption of certain cross-border supplies with the right to deduct, there will be a structural possibility that one person will claim a fiscal advantage while another person fails to declare or pay the corresponding tax. This does not mean that VAT neutrality should be weakened. It means that neutrality must be protected against abuse without being denied to honest taxable persons.

A general reverse charge for all B2B supplies would remove one important source of missing-trader fraud by preventing the supplier from receiving VAT and failing to remit it.[186] However, it would also change the logic of VAT as a tax collected fractionally. It would move the effective collection of tax closer to final consumption and would reduce the self-checking effect created by the ordinary relationship between output tax and input tax at each stage of the supply chain. For that reason, general reverse charge should be presented not as a simple solution, but as a structural alternative with significant systemic costs. The more realistic conclusion is that the Czech system will continue to depend on a combination of targeted reverse charge, increasingly sophisticated reporting, effective risk analysis, proportionate restorative measures and criminal-law repression in serious cases.

This conclusion is reinforced by the development of EU VAT law. The future of combating VAT fraud is increasingly connected with digital reporting, e-invoicing, platform-based transactions and cross-border exchange of data. These developments do not eliminate the legal questions analysed in this book. They intensify them. Better data may improve detection, but it does not itself determine whether a deduction should be denied, whether a tax should be secured, or whether a person should be punished. The core task of VAT law will therefore remain the same: to preserve neutrality while preventing that neutrality from being transformed into an instrument for extracting public revenue.

[186] ZÍDKOVÁ, 2023, ibid., p. 33.

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