



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

FIFTH SECTION

CASE OF SERKOV v. UKRAINE

(Application no. 39766/05)

JUDGMENT

STRASBOURG

7 July 2011

FINAL

07/10/2011

This judgment has become final under Article 44 § 2 of the Convention. It may be subject to editorial revision.

In the case of Serkov v. Ukraine,

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

Dean Spielmann, *President*,

Elisabet Fura,

Karel Jungwiert,

Boštjan M. Zupančič,

Mark Villiger,

Ganna Yudkivska,

Angelika Nußberger, *judges*,

and Claudia Westerdiek, *Section Registrar*,

Having deliberated in private on 14 June 2011,

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

PROCEDURE

1. The case originated in an application (no. 39766/05) against Ukraine lodged with the Court under Article 34 of the Convention for the Protection of Human Rights and Fundamental Freedoms (“the Convention”) by a Ukrainian national, Mr Sergey Nikolayevich Serkov (“the applicant”), on 25 October 2005.

2. The Ukrainian Government (“the Government”) were represented by their Agent, Mr Y. Zaytsev.

3. The applicant alleged he was unlawfully obliged by the authorities to pay value-added tax and this amounted to a violation of Article 1 of Protocol No. 1.

4. On 5 November 2009 the President of the Fifth Section decided to give notice of the application to the Government. It was also decided to rule on the admissibility and merits of the application at the same time (Article 29 § 1).

THE FACTS

I. THE CIRCUMSTANCES OF THE CASE

5. The applicant was born in 1961 and lives in Kharkiv. He is a private entrepreneur who has registered as a payer of the single (unified) tax in accordance with the Presidential Decree “On a Simplified System of Taxation, Accounting and Reporting for Small Business” no. 727 of 3 July 1998, with further amendments (“the Presidential Decree”).

6. Between March and July 2004, when the applicant imported goods into Ukraine, he was requested by the customs authority to pay value-added tax ("VAT") in accordance with the Law "On Value-Added Tax" of 3 April 1997 ("the VAT Act").

7. The total amount of the VAT imposed by the customs authorities was 214,107.19 Ukrainian hryvnias (UAH). The applicant paid the VAT required.

8. On 10 August 2004 the applicant instituted proceedings in the Kharkiv Regional Commercial Court against the customs authority and a local department of the State Treasury, seeking recovery of the VAT, arguing that he was covered by the simplified tax regime, as provided by the Presidential Decree. He specified that according to section 11 of the Law "On State Support for Small Business" ("the Small Business Act") the simplified system of taxation provided for the replacement of taxes and duties by the single (unified) tax. He further claimed that according to paragraph 6 of the Presidential Decree the single (unified) taxpayer was exempt from paying VAT. Therefore, no VAT obligations could arise in the course of his business activity.

9. On 2 September 2004 the court rejected the applicant's claim as unfounded, stating that the principles established in section 11 of the Small Business Act were not applicable as regards VAT because the relevant amendments had not been made to the VAT Act as required by section 11.4 of the latter Act. At the same time, the provisions of Sections 2 and 3 of the VAT Act indicated that the applicant's operations were subject to VAT. The court therefore concluded that the VAT Act did not make any exemptions for private entrepreneurs covered by the simplified taxation regime. Moreover, having regard to paragraph 1 of the Presidential Decree, which laid down the criteria for registering under a simplified system of taxation, the court found that that system provided VAT exemption with respect to sales operations only and did not cover import operations.

10. The applicant appealed, claiming that paragraph 6 of the Presidential Decree did not make any distinctions between import and sales operations. He argued that neither type of operation was subject to VAT if a person was registered under the simplified taxation regime.

11. On 2 November 2004 the Kharkiv Commercial Court of Appeal quashed the judgment of 2 September 2004 and found for the applicant, noting that the Ukrainian legislation provided for general and simplified systems of taxation. The latter provided for the substitution of VAT and other taxes and duties by a single (unified) tax. As the applicant had been registered under the simplified system of taxation, the first-instance court had wrongly referred to the VAT Act in support of the conclusion that the applicant's import operations were subject to VAT. The court of appeal further noted that paragraph 1 of the Presidential Decree set out only the conditions for applying a simplified taxation regime and did not

differentiate between business operations exempt from VAT. At the same time, paragraph 6 of the Presidential Decree provided VAT exemption without any reservation as to the type of business operation.

12. The customs authority appealed on points of law.

13. On 2 February 2005 the Higher Commercial Court quashed the judgment of 2 November 2004 and upheld the judgment of 2 September 2004. It referred to the VAT Act, which provided that both sales and import operations were subject to VAT. The court further referred to paragraph 1 of the Presidential Decree which, in its opinion, had not merely set out criteria for the application of a special taxation regime, but had also indicated that the single (unified) tax was targeting income received from business operations. Accordingly, the court concluded that the VAT exemption established by the Presidential Decree applied only to sales operations, while import operations fell under the general taxation regime. It further referred to the decision of the Supreme Court of 23 December 2003 in which the same approach had been applied in a similar case.

14. The applicant appealed to the Supreme Court on points of law. He reiterated that paragraph 6 of the Presidential Decree made no distinction between business operations and provided for a general exemption of single (unified) tax payers from the VAT obligations. He further referred to the Supreme Court decision of 15 January 2003 in which the VAT exemption provided by the Presidential Decree was interpreted as also covering import operations. He also claimed that under section 4.4.1 of the Law “On the Procedure for Payment of Taxpayers’ Liabilities to Budgets and State Purpose Funds” of 21 December 2000 (“the Taxpayer Liabilities (Payments) Act”) the courts were obliged to accept the interpretation of domestic law which was the more favourable to a taxpayer.

15. On 28 April 2005 a panel of the Supreme Court refused to open appeal proceedings in the applicant’s case.

II. RELEVANT DOMESTIC LAW AND PRACTICE

A. The Constitution of Ukraine of 28 June 1996

16. According to paragraph 4 of the Transitional Provisions of the Constitution, for three years after the Constitution came into effect the President of Ukraine was empowered to adopt decrees on economic issues not covered by the laws of the Parliament.

B. The Law of Ukraine “On Value-Added Tax” (“the VAT Act”) of 3 April 1997 (in force at the relevant time)

17. At the material time section 2 of the Act provided, *inter alia*, that any physical person or legal entity importing goods with the purpose of using or consuming such goods on the customs territory of Ukraine should be considered to be a payer of VAT, except for those physical persons who were not registered as VAT payers and who imported goods within the non-taxable limits.

On 25 March 2005 this provision was amended, providing, *inter alia*, that it applied to import operations regardless of which taxation regime had been chosen by the importer.

18. According to sections 3.1.1 and 3.1.2 of the Act VAT was applicable to both sales and import operations.

19. Section 11.4 of the Act provided that changes in the VAT charging regime could be introduced only by amendments to this Act.

C. The Law “On State Support for Small Businesses” (“the Small Business Act”) of 19 October 2000

20. Section 1 of the Act provides that the subjects of small businesses are, among others, physical persons who have registered as private entrepreneurs.

21. According to section 11 of the Act, the simplified system of taxation, accounting and reporting may be applied to the subjects of small businesses. The system provides for substitution of taxes and duties by a single (unified) tax.

D. The Law “On the Procedure for Payment of Taxpayers’ Liabilities to Budgets and State Purpose Funds” (“the Taxpayer Liability (Payments) Act”) of 21 December 2000 (in force at the relevant time)

22. Section 4.4.1 of the Act provided that if the norm of the law or another normative legal act issued on the basis of the law, or if the norms of different laws or normative legal acts offered ambiguous or multiple interpretations of the rights and obligations of taxpayers and supervising authorities, the decision taken should be in favour of the taxpayer.

E. The Presidential Decree “On a Simplified System of Taxation, Accounting and Reporting for Small Businesses” no. 727 (“The Presidential Decree”) of 3 July 1998 (with further amendments)

23. Paragraph 1 of the Decree provides that a simplified system of taxation, accounting and reporting may be applied to, among others, a private entrepreneur who has employed during a year a maximum of ten people under labour contracts and whose annual income from the sale of products, works and services does not exceed UAH 500,000.

24. Paragraph 6 of the Decree provides as follows:

“Small businesses paying the single (unified) tax shall not be considered payers of the following taxes and duties:

value-added tax, except for legal entities which have opted to pay single (unified) tax at the 6% rate;

corporate income tax;

personal income tax;

land tax;

duty for special use of natural resources ...”

F. Jurisprudence of the Ukrainian courts

25. On 15 January 2003 the Supreme Court adopted a decision in a dispute between a single (unified) tax payer and a customs authority concerning the charging of VAT on import operations. The Supreme Court noted that the Ukrainian legislation provided for general and simplified systems of taxation which operated separately. The general system of taxation was regulated by the Law “On the System of Taxation” of 25 June 1991 and by the laws dealing with particular taxes and duties. The simplified system of taxation was regulated by the Presidential Decree and the Small Business Act. The Supreme Court further found that the plaintiff, having been registered under the simplified system of taxation, was not obliged to pay VAT on import operations because the plaintiff’s VAT obligations had been replaced by the obligation to pay single (unified) tax. The Supreme Court therefore overturned the finding of the lower court suggesting that the VAT exemption was not applicable to import operations.

According to the information letter of 26 May 2003, the Higher Commercial Court recommended the lower commercial courts to take that decision into account in the course of consideration of tax disputes. The decision was also published in the specialised legal journal on commercial jurisprudence.

26. On 23 December 2003 the Supreme Court adopted another decision in a dispute between a single (unified) tax payer and a customs authority concerning the charging of VAT on import operations. The Supreme Court noted that the VAT Act provided for application of VAT to sales and import operations. At the same time, according to paragraph 1 of the Presidential Decree, the application of the simplified system of taxation depended on the amount of income earned from sales operations. The Supreme Court therefore concluded that the VAT exemption provided by the Presidential Decree applied only to sales operations and not to import operations.

By the information letter of 18 June 2004, the Higher Commercial Court, “complementing [its] information letter of 26 May 2003”, notified the lower commercial courts of that decision. The decision was further published in the specialised legal journal on commercial jurisprudence.

THE LAW

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

27. The applicant complained that the authorities had unlawfully obliged him to pay value-added tax. He relied on Article 1 of Protocol No. 1, which reads as follows:

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

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

A. Admissibility

28. The Government submitted that the application was manifestly ill-founded. They accepted that charging VAT to the applicant constituted interference with the applicant’s property rights. However, this interference was justified under the second paragraph of Article 1 of Protocol No. 1, providing that the States should not be prevented from enforcing such laws as they deem necessary to control the use of property in the public interest and to secure the payment of taxes.

29. They further argued that the lawfulness of the applicant’s obligation to pay the VAT in question had been confirmed by the domestic courts,

which were better placed to interpret the domestic legislation and assess the evidence. Lastly, in the Government's opinion, the interference with the applicant's property rights did not impose an excessive individual burden on the applicant, as the measures would be the same for any other private entrepreneur importing goods from abroad.

30. The applicant disagreed, claiming that the interference was contrary to domestic legislation, in particular to paragraph 6 of the Presidential Decree. The amendments to the VAT law adopted subsequently (see paragraph 18 above) indicated a lack of legal grounds for the measures in question. He further referred to decisions of the Supreme Court of 15 January and 23 December 2003 as examples of inconsistent interpretation of the domestic legislation on this matter by the domestic courts. He insisted that the courts should have chosen the legal interpretation which was the more favourable to the taxpayer.

31. The Court considers that the applicant's complaint raises questions requiring examination of the case on the merits. The Court further notes that the complaint is not inadmissible on any other grounds. It must therefore be declared admissible.

B. Merits

32. It is a common ground that charging VAT to the applicant constituted an interference with his property rights within the meaning of Article 1 of Protocol No. 1. The Court does not see any reason to hold otherwise. The question to be determined is therefore whether this interference was justified in accordance with the requirements of that provision.

33. The first and most important requirement of Article 1 of Protocol No. 1 is that any interference by a public authority with the peaceful enjoyment of possessions should be lawful: the second sentence of the first paragraph authorises a deprivation of possessions only "subject to the conditions provided for by law" and the second paragraph recognises that States have the right to control the use of property by enforcing "laws". Moreover, the rule of law, one of the fundamental principles of a democratic society, is inherent in all the Articles of the Convention. It follows that the issue of whether a fair balance has been struck between the demands of the general interest of the community and the requirements of the protection of the individual's fundamental rights becomes relevant only once it has been established that the interference in question satisfied the requirement of lawfulness and was not arbitrary (see *Iatridis v. Greece* [GC], no. 31107/96, § 58, ECHR 1999-II).

34. When speaking of "law", Article 1 of Protocol No. 1 alludes to the same concept to be found elsewhere in the Convention (see *Špaček s.r.o. v. the Czech Republic*, no. 26449/95, § 54, 9 November 1999). This concept

requires firstly that the measures should have a basis in domestic law. It also refers to the quality of the law in question, requiring that it be accessible to the persons concerned, precise and foreseeable in its application (see *Beyeler v. Italy* [GC], no. 33202/96, § 109, ECHR 2000-I).

35. The scope of the concept of foreseeability depends to a considerable degree on the content of the instrument in issue, the field it is designed to cover and the number and status of those to whom it is addressed. The mere fact that a legal provision is capable of more than one construction does not mean that it fails to meet the requirement of “foreseeability” for the purposes of the Convention. The role of adjudication vested in the courts is precisely to dissipate such interpretational doubts as remain, taking into account the changes in everyday practice (see *Gorzelik and Others v. Poland* [GC], no. 44158/98, § 65, 17 February 2004). The task of the supreme courts in securing a uniform and coherent application of the law cannot be underestimated in this regard (see, *mutatis mutandis*, *Tudor Tudor v. Romania*, no. 21911/03, §§ 29-30, 24 March 2009, and *Ștefănică and Others v. Romania*, no. 38155/02, §§ 36-37, 2 November 2010). A failure by a supreme court to cope with that task may produce consequences incompatible, *inter alia*, with the requirements of Article 1 of Protocol No. 1 (see *Păduraru v. Romania*, no. 63252/00, §§ 98-99, ECHR 2005-XII (extracts)).

36. The Court admits that it is primarily for the national authorities to interpret and apply domestic law. However, the Court is required to verify whether the way in which the domestic law is interpreted and applied produces consequences that are consistent with the principles of the Convention, as interpreted in the light of the Court’s case-law (see *Scordino v. Italy (no. 1)* [GC], no. 36813/97, §§ 190 and 191, ECHR 2006-V).

37. In the present case the applicant’s claim against the customs authority was refused as the courts found that the VAT exemption was not applicable to the import operations undertaken by the applicant. However, the legal provisions concerning the scope of the VAT exemption were subjected to divergent interpretations by the domestic courts. In particular, on 15 January 2003 the Supreme Court adopted a guiding decision suggesting that the VAT exemption was applicable to import operations undertaken by a single (unified) tax payer (see paragraph 25 above). Subsequently, on 23 December 2003 the Supreme Court adopted the opposite approach, finding that VAT exemption was not applicable to import operations carried out by such taxpayers. That decision was disseminated and officially recommended for guidance in June 2004 (see paragraph 26 above), that is, at the time when the applicant was in the process of importing goods from abroad (see paragraph 6 above).

38. It cannot be excluded that the entitlement to the VAT exemption, as interpreted by the Supreme Court on 15 January 2003, was a significant factor in the applicant’s decisions to enter into commercial agreements

preceding the relevant import operations. It appears however that at a certain moment of his business activity the applicant had to discover that the guiding interpretation as to the taxation regime in respect of import operations had drastically changed.

39. The Court admits that there may indeed be cogent reasons why the guiding legal interpretations need to be revised. The Court itself, applying dynamic and evolutive approaches in interpreting the Convention, may depart, where necessary, from its previous interpretations, ensuring thereby the effectiveness and contemporariness of the Convention (see *Vilho Eskelinen and Others v. Finland* [GC], no. 63235/00, § 56, ECHR 2007-IV, and *Scoppola v. Italy (no. 2)* [GC], no. 10249/03, § 104, ECHR 2009-...).

40. However, the Court cannot discern any justification for the shift of legal interpretation the applicant faced. In fact no reasons were given by the Supreme Court to explain the reinterpretation in question. Such a lack of transparency must have affected public confidence and trust in the law. In the circumstances of the present case the Court considers that the manner in which the domestic courts interpreted the relevant legal provisions undermined their foreseeability.

41. The Court further notes that the possibility of such divergent interpretations of the same legal provisions was essentially generated by the inappropriate state of domestic law on this issue. The rules contained in the Presidential Decree and the VAT Act gave unjustified leeway in interpreting the ways in which they could be correlated, as well as in understanding the exact scope and meaning of their requirements.

42. Accordingly, in the Court's opinion, the lack of the required foreseeability and clarity of the domestic law on such an important fiscal issue, producing opposing judicial interpretations, upset the requirement of "quality of law" under the Convention.

43. In this regard the Court cannot overlook the requirement of section 4.4.1 of the Taxpayer Liability (Payments) Act, which provided that if domestic legislation offered ambiguous or multiple interpretations of the rights and obligations of the taxpayers the domestic authorities were obliged to take the approach which was more favourable to the taxpayer. However, in the present case the authorities opted for the less favourable interpretation of the domestic law, which resulted in the applicant being charged VAT (see also *Shchokin v. Ukraine*, nos. 23759/03 and 37943/06, § 57, 14 October 2010).

44. The foregoing considerations are sufficient to enable the Court to conclude that the interference with the applicant's property rights was not lawful for the purposes of Article 1 of Protocol No. 1. It holds for this reason that there has been a violation of that provision.

II. OTHER ALLEGED VIOLATIONS OF THE CONVENTION

45. The applicant complained under Articles 6 § 1 and 13 of the Convention that the proceedings in his case were unfair, alleging that the courts had applied the domestic law wrongly.

46. Having considered the applicant's submissions in the light of all the material in its possession, the Court finds that, in so far as the matters complained of are within its competence, they do not disclose any appearance of a violation of the rights and freedoms set out in the Convention.

47. It follows that this part of the application must be declared inadmissible pursuant to Article 35 §§ 3 (a) and 4 of the Convention.

III. APPLICATION OF ARTICLE 41 OF THE CONVENTION

48. Article 41 of the Convention provides:

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

A. Damage

49. The applicant claimed UAH 249,044.2¹ in respect of pecuniary damage, which comprised the amount of the impugned VAT (UAH 214,107.19²) plus the amount of inflation losses (UAH 34,937.01³) incurred by the applicant up to the date of the application being lodged with the Court. The applicant further claimed UAH 50,000⁴ in respect of non-pecuniary damage.

50. The Government submitted that the claims were unsubstantiated, relying essentially on their assumption that the application was manifestly ill-founded.

51. The Court has found that charging the applicant the VAT was not lawful for the purpose of Article 1 of Protocol No. 1. It therefore considers that the reparation of the violation found should entail the reimbursement of the VAT unduly paid by the applicant. As regards the inflation losses, the Court reiterates that the adequacy of compensation would be diminished if it were to be paid without reference to various circumstances liable to reduce its value (see, for example, *Wasserman v. Russia* (no. 2), no. 21071/05,

1. About EUR 23,048 on the date of the claim

2. About EUR 19,815 on the date of the claim

3. About EUR 3,233 on the date of the claim

4. About EUR 4,627 on the date of the claim

§ 71, 10 April 2008). The Court notes that the applicant presented a detailed calculation of inflation losses based on the official tables, and that the Government submitted no objections to the applicant's claim or the method of calculation. The Court finds these calculations reasonable (see *Skaloukhov and Others v. Ukraine*, nos. 8107/06, 8473/06, 8475/06, 15941/06 and 32116/06, § 37, 19 November 2009). In sum, the Court finds that the applicant's claims for pecuniary damage are substantiated and rounds the award in this respect to EUR 23,000.

52. As regards the non-pecuniary damage, the Court finds that the applicant must have suffered non-pecuniary damage on account of the violation found. Ruling on an equitable basis, as required by Article 41 of the Convention, it awards EUR 4,000 to the applicant under this head.

B. Costs and expenses

53. The applicant did not submit any claim under this head. The Court therefore makes no award.

C. Default interest

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

FOR THESE REASONS, THE COURT UNANIMOUSLY

1. *Declares* the complaint concerning Article 1 of Protocol No. 1 admissible and the remainder of the application inadmissible;
2. *Holds* that there has been a violation of Article 1 of Protocol No. 1;
3. *Holds*
 - (a) that the respondent State is to pay the applicant, within three months of the date on which the judgment becomes final, in accordance with Article 44 § 2 of the Convention, the following amounts, to be converted into the national currency of the respondent State at the rate applicable on the date of settlement:
 - (i) EUR 23,000 (twenty-three thousand euros), plus any tax that may be chargeable, in respect of pecuniary damage;
 - (ii) EUR 4,000 (four thousand euros), plus any tax that may be chargeable, in respect of non-pecuniary damage;

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

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

Done in English, and notified in writing on 7 July 2011, pursuant to Rule 77 §§ 2 and 3 of the Rules of Court.

Claudia Westerdiek
Registrar

Dean Spielmann
President