

# TRANSACTION-RELATED GROUNDS FOR ELIGIBILITY FOR TAX CREDIT: OVERVIEW OF THE CASE-LAW OF THE SUPREME COURT OF UKRAINE

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**notation.** The purpose of the study is to determine the transaction-related grounds for the right to a tax credit that are covered in the case-law of the Supreme Court of Ukraine. The relevance of this topic arises from the fact that there is insufficient cohesion in the scientific literature on the understanding of the whole spectrum of these grounds in their interrelation by administrative courts. As a result of the study, the author points out that the transaction-related grounds for the right to a tax credit are: (1) the genuineness of transactions for the purchase of goods/services; (2) the orientation of these transactions to the increase (preserve) taxpayer's assets and/or its value, as well as to the creation of conditions for that in the future; (3) using the relevant goods/services in the taxpayer's business activities and in transactions subject to value-added tax; (4) keeping sufficient record of business transactions in source documents and their congruence with the taxpayer's contracts. It is also noteworthy, the failure of the taxpayer's counterparty to fulfill their obligation to pay their value-added tax duties, their registration and management of its activities by figureheads, the lack of material, technical and labor resources for carrying out business transactions and other tax information regarding the taxpayer's counterparties in the supply chain are circumstances that are not of decisive importance and must be assessed in the context of specific business transactions at the time of specific business transactions and in view of other circumstances that confirm or refute the movement of assets and funds between counterparties. Similarly, presentation of unreliable information in source documents, them being issued by an unauthorized person, incomplete disclosure of some details of business transactions and other deficiencies of source documents do not entail their non-inclusion in tax accounting, if from the set of documents containing information about the business transaction, it is possible to establish the its date, essence and scale, as well as to identify the business actors who participated in the business transaction.

**Key words:** genuineness of business transactions, sham transaction, source documents, value added tax, tax control, tax credit, value-added tax refund.

## 1. Introduction.

The traditional mechanism of value-added tax involves the calculation of the amounts of this tax at each link in the chain of supply of goods/services to the final consumer and the inclusion of this tax in the price of the goods/services as well as its actual payment by the buyer of goods/services. To prevent double taxation the law provides for the right of the taxpayer to reduce their tax liabilities arising from the supply of goods/services to their buyers by a tax credit in the amount of the sums that the taxpayer actually paid to the suppliers of goods/services for their use in the taxpayer's business activities within the taxable transactions. However, in the tax administration practice, there are often cases when taxpayers carry out sham transactions for the purchase of goods/services in order to artificially increase the amounts of tax credit, by which they can reduce their value-added tax duties. Because of this, tax control measures are carried out to examine transactions of taxpayers against the requirements related to eligibility for a right to a tax credit. At the level of tax legislation, these requirements are usually set out using general wording, according to which the business transaction must be actually carried out (genuine) and confirmed by properly executed source documents. At the same time, specific criteria for compliance with these requirements and standards of proof are being developed in the case-law of administrative courts, which is why its scientific study for its

generalization and outlining ways of its further improvement is important for properly ensuring the fulfillment of taxpayers' right to a tax credit while simultaneously preventing the unjustified accrual of tax credit amounts in the event of illegal minimization of tax duties.

## 2. Analysis of scientific publications.

In the scientific literature, judicial case-law on transaction-related grounds for eligibility for tax credit is given considerable attention. The central place in many studies have the considerations of courts on the legal and factual grounds for qualifying certain business transactions as genuine or sham, as well as the well-established approaches to the assessment of source accounting documents. In particular, in Ukraine, the judicial doctrines of 'genuineness of business transactions', 'business purpose', "prevalence of substance over form", "due diligence of the taxpayer in choosing a business counterparty" are studied by Krylov [1], Maletska [2], Malinovska [3] and Khanova [4]. At the same time, their researches are dedicated only to certain criteria for assessing business transactions. In view of this, the task of comprehending and systematizing all these criteria in their interrelationship poses as relevant.

## 3. The purpose of the work.

The purpose of the study is to determine the transaction-related grounds for the right to a tax credit that are covered in the case-law of the Supreme Court of Ukraine.

## 4. Review and discussion.

At the outset of this research, it is to be noted that of paramount importance in determining the existence of grounds for the right a tax credit is the actual (genuine) conduct of business transactions, that is, their causing the movement of assets, changes in the structure of liabilities or equity of the taxpayer (changes in the property) of the taxpayer. According to the conclusion of the Supreme Court of Ukraine in the case no. 160/3364/19, the confirmation of a business transaction is precisely the movement of assets and funds between counterparties, while the primary documentation is a reflection of such a transaction [5].

Another intrinsic feature of economic transactions is their execution with a reasonable economic reason (business purpose).

Pursuant to Article 14(14.1.231) of the Tax Code of Ukraine, a reasonable economic reason (business purpose) is a reason that can be present only if the taxpayer intends to obtain an economic effect as a result of economic activity. The economic effect, in particular, but not exclusively, provides for the increase (preservation) of the taxpayer's assets and/or its value, as well as the creation of conditions for such an increase (preservation) in the future [6]. Interpreting these provisions, the Supreme Court of Ukraine indicates that it is not necessary for the economic effect to be observed immediately after the transaction. It is not excluded that such an effect will occur in the future, and it is also not excluded that as a result of objective reasons the economic effect may not occur at all. On the other hand, if a particular transaction is not due to reasonable economic reasons (devoid of a business purpose), then such transactions are not committed within the economic activity, and therefore, their consequences are not to be reflected in tax accounting (Judgment of the Supreme Court of Ukraine of 1 December 2021, case no. 140/6978/20) [7].

For example, the fictitiousness of business transactions and the groundlessness of them being reflected in accounting and tax records may be indicated by, among other things:

- impossibility of actually carrying out transactions in view of the time, location of property or the volume of material resources economically necessary for the production of goods, performance of works or services;
- non-performance of a person listed as a supplier of goods/services of respective entrepreneurial activity;

- absence of the necessary conditions for achieving the outcomes of the relevant economic activity due to the lack of managerial or technical personnel, fixed assets, production assets, warehouses, and vehicles;
- taxation-driven accounting only of those transactions that are directly related to the occurrence of a tax benefit, if this type of activity also requires the performing and accounting of other business transactions;
- carrying out transactions with goods that were not produced or could not be produced in the volume specified by the taxpayer in the accounting documents;
- lack of accounting documents (Judgment of the Supreme Court of Ukraine of 6 July 2023, case no. 120/17523/21-a) [8].

In the practice of resolving disputes about the existence of tax consequences of business transactions, their genuineness is often questioned due to signs of fictitious activity of the taxpayer or the participants in such transactions and their failure to fulfill their tax obligations. First of all, in this regard, it is to be indicated that the well-established standpoint in the jurisprudence is that if the counterparty has not fulfilled its obligation to pay the amount of its value-added tax duties, this is not a basis for depriving the taxpayer of the right to a value-added tax refund in the event that such a taxpayer has fulfilled all the conditions stipulated by law for receiving such a refund and has the necessary confirmation of the amount of its tax credit (Judgment of the Supreme Court of Ukraine of 31 January 2011, case no. 21-47a10-a) [9].

In addition, the possibility of accruing a tax credit for transactions involving shell business entities is not excluded. In this regard, the Supreme Court of Ukraine emphasized that a shell business entity is a legal entity, despite defects in its creation or purpose (in particular, its creation by individuals for monetary remuneration without the purpose of conducting financial and economic activities, who did not know who subsequently compiled and signed tax reports and other documents on behalf of the business entity). Substantiating this conclusion, the court indicated that the legislation does not consider the inconsistency of a person's civil-law powers to act on behalf of a legal entity as an independent basis for the inadequacy of the executed source documents, and the source documents drawn up by it do not deprive them of legal significance in the event of actual movement of assets. It was also concluded that evidence of fictitious entrepreneurship should be assessed by the administrative court along with the source documents, the correctness of their execution, the possibility of performing disputed economic transactions, their connection with the taxpayer's economic activities, and the possible use of the purchased goods (works, services) in further activities (Judgment of the Supreme Court of Ukraine of 7 July 2022, case no. 160/3364/19) [5].

Equally, tax information on counterparties in the supply chain, the absence of counterparties of the taxpayer by location, the cancellation of their certificates of value-added tax payers, the absence of personnel and material resources, fixed assets for carrying out economic transactions cannot indicate the absence of a business purpose and/or the taxpayer's awareness of the illegal nature of the activities of their counterparties, as well as the unreliability of the declared tax accounting data (Judgment of the Supreme Court of Ukraine of 6 July 2023, case no. 120/17523/21-a) [8].

On the other hand, if circumstances are established in the litigation that indicate that the taxpayer was or could have been aware of the unlawful activities of their counterparty (illegal minimization of tax duties), in particular, through creating artificial grounds for increasing expenses and/or tax credit, or if the taxpayer acted without due diligence or caution when choosing a counterparty that does not fulfill its tax obligation, under established circumstances that refute the reality of economic transactions, the tax benefit received by such a taxpayer in the form of the right to expenses and tax credit is recognized as groundless (Judgment of the Supreme Court of Ukraine of 5 May 2023, case no. 160/15514/20) [10]. The tax authority that denies the taxpayer's eligibility for a tax credit in such circumstances must prove that a bona fide taxpayer could have verified the veracity of the relevant documents by reasonable measures and also had sufficient grounds, acting with due diligence, for reasonable doubts about their content (Judgment of the Supreme Court of Ukraine of 7 July 2022, case no. 160/3364/19) [5].

The genuineness of business transactions is verified both by clarifying the circumstances regarding the possibility of their conduct, and by establishing the availability and content of the taxpayer's contracts and source documents regarding their fulfillment.

In this regard, the Supreme Court of Ukraine noted that business transactions must correspond to the economic effect reflected in the contracts concluded by the taxpayer and be confirmed by properly executed source documents. In other words, to confirm the actual implementation of business transactions, the taxpayer must have the appropriate source documents, which must be properly executed, contain all the necessary details, be signed by authorized persons and which, together with the established circumstances of the case, in particular, regarding the possibilities of economic entities to carry out the relevant transactions, must testify to the indisputable fact of the actual implementation of business transactions, which is the basis for the taxpayer to form tax accounting data (judgment of the Supreme Court of Ukraine of 6 July 2023, case no. 120/17523/21-a) [8].

At the same time, the Ukrainian well-established case-law indicates as well that for source documents to be given weight in tax accounting, it is sufficient to reflect in only the minimum necessary information that allows to verify the actual implementation of the relevant business transactions. Under this condition, the absence of other parts of the source document does not lead to its loss of evidentiary value.

In particular, in the case no. 826/5911/18, the Supreme Court of Ukraine took the view that for tax accounting purposes, in light of the approach of the prevalence of substance over form, the economic consequences created by business transactions are taken into account primarily, and not the specifics of the record of the relevant transactions (Judgment of the Supreme Court of Ukraine of 27 July 2020, case no. 826/5911/18) [11].

Applying this approach in the case no. 160/20895/21, the Supreme Court of Ukraine stated that insignificant deficiencies in documents representing information about a business transaction are not grounds for non-recognition of a business transaction, provided that such deficiencies do not prevent the possibility of identifying the person who participated in the business transaction and contain information about the date of making of the document, the name of the enterprise on whose behalf the document was prepared, the essence and scope of the business transaction, etc. For example, as the court noted, the absence of shipping documents that are provided at the request of the buyer and are not reflected in tax/accounting is irrelevant for assessing the adequacy of documentary evidence of business transactions. Equally, the failure to indicate in the expense invoice the position of the person who received the goods, if there is a signature of the person affixed with the seal of the business entity, cannot indicate the absence of business transactions for the supply of goods, in addition, expense invoices contain all the details of the business entity (Judgment of the Supreme Court of Ukraine of 1 December 2022, case 160/20895/21) [12].

Moreover, the Supreme Court also holds the opinion that the fact of using source documents with unreliable data to confirm the circumstances of a business transaction should not automatically indicate the groundlessness of the tax accounting data. In other words, a bona fide taxpayer who used the relevant document to confirm his tax accounting data cannot suffer any negative consequences if other circumstances specified in the source document, in particular the movement of the relevant assets, took place (Judgment of the Supreme Court of Ukraine of 7 July 2022, case no. 160/3364/19) [5].

The most complex cases of assessing documentary evidence of business transactions when determining their genuineness and the existence of the relevant taxpayer's right to accrue a tax credit occur when verifying non-commodity transactions.

In this regard, one could turn to the reasoning of the Supreme Court of Ukraine, which noted that marketing services, as well as consulting, promotion services, and information services belong to non-commodity transactions. For the formation of a tax credit for transactions for such services a necessary condition is to prove the direct connection of such transactions with the taxpayer's economic activities and their confirmation by appropriate source documents, the mandatory maintenance and storage of which is provided for by the accounting rules, and other documents that would certify the fact of the economic transaction (Judgment of the Supreme Court of Ukraine of 23 October 2020, case no. 815/2126/15) [13]. For example, confirmation of the connection of marketing service costs with the economic activity of the business entity may be: an internal administrative act of the enterprise on the need to conduct such marketing research, the time of its conduct, territory, boundaries, etc., a contract for conducting marketing research, indicating the its type, purpose, etc. In order to confirm the actual receipt of marketing services, an act of acceptance and transfer of services or another document confirming the actual provision of such services, a report on conducting

marketing research setting out the outcomes of such research and provide recommendations to the customer, may be provided. The report on conducting marketing research should contain information, in particular, on the analysis of competition between the largest manufacturers in the wholesale and retail sales markets and an assessment of the level of competition, the main trends in market development, price change dynamics, product (goods) assortment, pricing policy, analysis of imports and exports of products (goods) and their impact on the market, potential consumers and quantitative indicators (market capacity) of planned sales, forecast sales plan, risk assessment, financial plan, analysis of project effectiveness, forecast level of profitability, project payback period, conclusions and recommendations based on the results of the research (judgment of the Supreme Court of Ukraine of 25 March 2021, case no. 813/2781/17) [14].

## 5. Conclusions.

Having regard to the above considerations, it could be summarized that the transaction-related grounds for the right to a tax credit are: (1) the genuineness of transactions for the purchase of goods/services; (2) the orientation of these transactions to the increase (preserve) taxpayer's assets and/or its value, as well as to the creation of conditions for that in the future; (3) using the relevant goods/services in the taxpayer's business activities and in transactions subject to value-added tax; (4) keeping sufficient record of business transactions in source documents and their congruence with the taxpayer's contracts. It is also noteworthy, the failure of the taxpayer's counterparty to fulfill their obligation to pay their value-added tax duties, their registration and management of its activities by figureheads, the lack of material, technical and labor resources for carrying out business transactions and other tax information regarding the taxpayer's counterparties in the supply chain are circumstances that are not of decisive importance and must be assessed in the context of specific business transactions at the time of specific business transactions and in view of other circumstances that confirm or refute the movement of assets and funds between counterparties. Similarly, presentation of unreliable information in source documents, them being issued by an unauthorized person, incomplete disclosure of some details of business transactions and other deficiencies of source documents do not entail their non-inclusion in tax accounting, if from the set of documents containing information about the business transaction, it is possible to establish its date, essence and scale, as well as to identify the business actors who participated in the business transaction.

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