THE EUROPEAN JUDICIAL PRACTICE REGARDING THE VAT DEDUCTION RIGHT AND ITS IMPACT ON THE HUNGARIAN PRACTICE

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Abstract

The purpose of the below study is to compare the European judicial practice with the Hungarian practice in terms of VAT deduction right. In the meantime, the study gave us the opportunity to get to know the complex requirements of VAT deduction right. In addition, we were also able to assess whether the Hungarian VAT Act is in line with the community legislation.

Keywords*: Value added tax, deduction right, European judicial practice, tax fraud, Hungarian VAT.*

Introduction

The value added tax ('VAT') is often called as the 'queen of taxes' which name has several reasons. One of the most important reasons is that VAT provides the largest amount (appr. 1/3) of tax to the Hungarian budget comparing to other taxes.[1] From an economical point of view, a tax may be considered as good if it meets the following three requirements: (1) it is fair and square, (2) the direct cost of tax administration is relatively low and (3) it hardly impacts on the behaviour of private individuals and businesses. However, the completion of these requirements in case of VAT is argued nowadays. Indirect taxes are generally fair and square thus taxable persons have the right to decide how much they spend of their income and consequently how much tax they pay. The direct cost of tax administration is also considered as low in case of VAT.[2]

After joining the European Union ('EU') taxation became one of the most important and interesting fields. Within taxation, VAT has an especially important role thus the citizens of the EU meet this type of tax every day and the rate of the Hungarian VAT is very high which means

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[1] https://www.portfolio.hu/gazdasag/adozas/kell-e-nekunk-ez-az-afa.192931.html Lentner Csaba:.Az adórendszer és a közpénzügyek egyes elméleti, jogszabályi és gyakorlati összefüggései. Európai Jog: Európai Jogakadémia Folyóirata, 18. évf. 5. szám, p. 30-36. Csűrös, Gabriella: Tax system in Hungary and its changes due to the crisis – pioneer or hazardous method of sectoral taxation? In: Marcin Burzec–Pawel Smolen (eds.): Tax authorities in the Visegrad Group countires. Common experience after accession to the European Union. Wydawnictwo KUL, Lublin, 2016. p. 103–105.

[2] Ercsey Zs. Az általános forgalmi adóról, Jura Kiadó, Budapest 2012, p. 73. Lentner Csaba : The New Hungarian Public Finance System – in a Historical, Institutional and Scientific Context. Public Finace Quaterly, Vol. 60. no. 4. p. 447-461. Zoltán Nagy-Beáta Gergely-Balázs Katona: Problems Relating to Tax Avoidance and Possible Solutions in the European Union's and Hungarian 's Regulation, Curentul Juridic XXI. no 3.(74), 2018.

massive burden for those who eventually become liable for the payment of VAT.

In our study, we examined the regulation in effect currently, focusing on the VAT deduction right which incurs several questions and problems. In order to understand and solve these problems we also examined the practice of the European Court of Justice ('ECJ') which usually gives direction in order to interpret the regulations in question. By doing this, we also got a view in that regard which are the most common problems and questions either in Hungary or in the EU.

According to the Directive[3], those customers have VAT deduction right who are not qualified as the final customer i.e. the subject of VAT but they sell forward the goods or services or build them in into their own goods or services. The deduction of VAT however, has several further requirements. Considering that the examination of VAT deduction right (whether it is deductible or not) is rather long, a large number of tax fraud connects to this process. Consequently, transparency is feasible with the continuous audit of the processes and with very strict administrative requirements (invoice, customs declaration and VAT returns). Administrative requirements should also include the following obligations: economic operators are obliged to notify the Hungarian Tax and Customs Authority ('HTCA') if they commence, cease or amend taxable activities. They are also obliged to issue invoices (the exact content of the invoices is determined in the community and national regulation) and are obliged to submit VAT returns regularly. Based on these VAT returns economic operators are obliged to pay VAT, which is the difference between the VAT payable and VAT deductible. VAT may be deducted promptly if all the requirements are fulfilled therefore the subjects of VAT should not have fiscal burden in a long term (i.e. a taxable person may assess the payable VAT and deductible VAT in the same return which results a financial simplification).[4]

It is also possible that deductible VAT exceeds the amount of payable VAT. In this case, the Member States of the EU have different solutions. In Germany the tax authority reimburses the amount automatically, in Hungary besides reimbursing it, it is also possible to roll over the amount (surplus) in the following VAT period and deduct the amount from the payable VAT.[5] However, we need to differentiate the conditions of VAT deduction and the conditions of reimbursing VAT from the HTCA (the second also depends on the amount of surplus). VAT refund is also another term, which should mean the refund of VAT incurred in another Member State (based on Directive 8th) or in a third country (based on Directive 13th).

Another problem is that the goods or services acquired may serve both taxable and VAT exempt business purposes. Based on the Directive a ratio should be calculated in this case and VAT may be deducted according to this ratio. However, the

[3] Council Directive 2006/112/EC of 28 November 2006 on the common system of value added tax Article 168: "In so far as the goods and services are used for the purposes of the taxed transactions of a taxable person, the taxable person shall be entitled, in the Member State in which he carries out these transactions, to deduct the following from the VAT which he is liable to pay...".

[4] Council Directive 2006/112/EC of 28 November 2006 on the common system of value added tax Article 167: "*A right of deduction shall arise at the time the deductible tax becomes chargeable*.".

[5] Nagy Zoltán-Szesztai Zsuzsanna: *Az adólevonási jog gyakorlásának feltételei*, Gazdaság és Jog, 2010./6.sz.

application of this rule causes several problems in practice.[6]

Having reviewed the practice of the ECJ, it may be established that the harmonization of the community and national VAT regulation is not completed yet. This leads us to the question which regulation should be applied.[7] This question was cleared in case Van Gend En Loos[8]. This case declared the direct effect of Directive based on which the rules of Directive concern not solely to Member States but also the citizens (i.e. the primary source of law has direct effect).

1. The problem of state aids

Considering the cases of the Hungarian Court regarding VAT, it may be established that the ECJ has a dominant effect on the national decisions. One of the most important Hungarian cases is the Parat case[9], which concerns to the deduction of VAT in terms of state aids. Parat (acting in the name of the Hungarian Economic and Traffic Ministry) entered into agreement with the Hungarian Bank of Development on 11 May 2005 covering the extension of the capacity of its plant which development was also implemented in that year. Based on the agreement Parat received a non-refundable aid and deducted the input VAT incurred in relation to this development. The HTCA during an audit assessed that Parat should not have deducted VAT due to the non-refundable state aid based on that the Hungarian VAT Act (in effect in 2005) which sets forth that taxable person should differentiate the deductible and non-deductible VAT in its administration. In addition, the VAT of acquisitions paid from the state aid should not be deductible as it should not be qualified as the base of VAT. Therefore, HTCA assessed VAT shortage, tax penalty and late payment penalty. Parat argued the resolution of HTCA thus the national rule in question was not harmonized with the respective provisions of the Directive. Parat referred to the general provisions of the Directive i.e. the acquisitions served taxable business purposes therefore input VAT should be deducible irrespective of the fact that it was paid from the state aid. Based on the former decisions of ECJ this general rule may solely be restricted in very special cases. ECJ assessed that the national provision which restricts the VAT deduction right in case of state aids is not in line with the Directive and Parat is entitled to apply the provisions of the Directive directly.

2. Problems in terms of invoicing

Similarly to the above, ECJ assessed as the restriction of VAT deduction right the following Hungarian rules regarding the too strict rules of the amendment of invoices

[6] Council Directive 2006/112/EC of 28 November 2006 on the common system of value added tax Article 173: "In the case of goods or services used by a taxable person both for transactions in respect of which VAT is deductible pursuant to Articles 168, 169 and 170, and for transactions in respect of which VAT is not deductible, only such proportion of the VAT as is attributable to the former transactions shall be deductible.".

[7] Veronika Szikora: Company Legislation and Reforms in Europe, Curentul Iuridic XXI: 1(72) 2018, p. 155-171.

[8] C-26-62 NV Algemene Transport- en Expeditie Onderneming van Gend & Loos v Netherlands Inland Revenue Administration, dated: 5 February 1963, issued by ECJ.

[9] C-74/08 PARAT Automotive Cabrio Textiltetőket Gyártó kft v Adó- és Pénzügyi Ellenőrzési Hivatal Hatósági Főosztály Észak-magyarországi Kihelyezett Hatósági Osztály, dated: 23 April 2009, issued by ECJ, Éva Erdős: Law of Public Finance int he EU – The European Tax Harmonization, University "Petru Maior" Publishing House, Tirgu Mures, 2011, p. 134-136.

(case Pannon Gep[10]). The claimant of this case (Pannon Gep Centrum) entered into agreement with Betonut Szolgaltato es Epito Zrt. ('Betonut') covering the implementation of bridge restructuring works to Betonut. The claimant delegated the work to several subcontractors. Subsequent to the completion of the work the certificates (certificate of completion of the work) and invoices were also issued however, HTCA questioned the VAT deduction right of the claimant in a tax audit due to the incorrect date of supply in the invoices. The claimant also recognized its failure and issued corrective invoices including the correct dates. Subsequently, HTCA reviewed the invoices and assessed that the corrective invoices do not fulfil the requirements of invoices (continuous sequence of invoices). The cancelling invoices and corrected invoices are in a different sequence of numbering (cancelling invoices started with '2005' while the correct invoices started with JESB2008). The claimant turned to ECJ with the question whether it is contrary to the community law if the national law restricts the VAT deduction right based on a requirement, which is set forth by the national law. According to the decision of ECJ this provision of the national law which restricts the VAT deduction right based on a formal requirement of invoices is not in line with the Directive provided that the correction of the invoices are performed by the claimant, input VAT should be deductible.

3. Further problems regarding the restriction of VAT deduction right

We should also mention case Mahageben[11] and case Toth[12]. ECJ sets forth in both cases that HTCA might restrict the VAT deduction right if it is able to support with objective evidence that the seller knew or should have known regarding the tax fraud of its customer. In case of Mahageben, the claimant entered into agreement covering transportation services for a fixed period. During this period its business partners issued sixteen invoices to the claimant, including different amount of goods transported. However, the delivery was supported only in case of six invoices with delivery notes. The business partners paid the respective VAT supporting that the transactions were indeed performed. The claimant also declared these transactions and deducted input VAT. The goods transported by the business partners of the claimant were further sold to different companies (which movement of goods was administrated by the claimant). Considering the absence of delivery notes both the claimant and the business partners declared that they did not retain them. However, in a later phase of the tax audit they were able to provide the HTCA with the copies of the delivery notes. HTCA assessed that the claimant has no deduction right in terms of the acquisitions in question due to the fact that it does not have the proper documentation which supports the completion of these transactions. In addition, the claimant did not audit its business partners properly. Based on the decision of ECJ this provision

[10] C-368/09 Pannon Gép Centrum Kft v APEH Központi Hivatal Hatósági Főosztály Dél-dunántúli Kihelyezett Hatósági Osztály, dated: 15 July 2010, issued by ECJ.

[11] C-80/11 and C-142/11 Mahagében kft v Nemzeti Adó- és Vámhivatal Dél-dunántúli Regionális Adó Főigazgatósága and Péter Dávid v Nemzeti Adó- és Vámhivatal Észak-alföldi Regionális Adó Főigazgatósága (C-142/11), dated: 21 June 2012, issued by ECJ.

[12] C-324/11 Gabor Toth v Nemzeti Adó- és Vámhivatal Észak-magyarországi Regionális Adó Főigazgatósága, dated: 6 September 2012, issued by: ECJ.

of the national law which restricts the VAT deduction right based on the absence of delivery notes (provided that invoice was issued in relation to the transactions) and the absence of the audit of the business partners is not in line with the Directive.

4. The practice of ECJ in terms of VAT deduction right

ECJ searched for the answer in case Investrand[13] for the question whether taxpayers have right to deduct input VAT if their acquisitions do not have direct and prompt relationship with the sales of the taxpayers (i.e. their business activity) but these acquisitions are part of the general costs therefore are built in the price of the sold products and services. In this case ECJ decided that input VAT may not be deducted if the acquisitions are not in a prompt and direct relationship with the sales of taxpayers i.e. do not serve the business activity.

Contrary to the above decision of ECJ, it granted the right to deduct input VAT in case Inzo[14]. In this case, the taxpayer deducted input VAT before the commencement of its business activity however, eventually the taxpayer was not able to start its activities at all but performed several preparatory transactions. Surprisingly, ECJ decided that in this case the taxpayer has VAT deduction right in spite of its non-existing business activity (the direct and prompt relationship between the acquisitions and the business activity may not be determined).

ECJ reached the same conclusion in case Fini[15]. Fini H provided catering services to its customers for which it leased several premises. The lessor leased the premises for a fixed period of 10 years which contract might not be terminated during the 10-year period. However, Fini H ceased its activities before the end of the lease agreement and was not able to terminate the contract. Fini H was registered for VAT purposes until the end of the lease contract and deducted input VAT incurred in relation to the maintenance of the premises (utilities, phone charges etc.). ECJ agreed with the practice of Fini H due to the fact that there should be no connection between the performance of economic activity and the VAT deduction right. VAT may be deducted in case of preparatory activities as well as in case of disposal activities since these activities are related to the business activity of the taxpayer.

As discussed earlier, ECJ examined the VAT deductibility of general costs several times. Contrary to case Investrand, ECJ assessed the VAT deduction right in case Kretztechnik[16]. The taxpayer (seated in Austria) asked for the admission to Frankfurter listing and deducted input VAT incurred in relation to this process despite of the fact that issuing shares should be qualified as VAT exempt transactions. Based on this the Austrian Tax Authority rejected the VAT deduction right of the taxpayer. According to the opinion of ECJ, the taxpayer admitted itself to listing due to financial reasons (capitalisation) which serves its taxable business activity. For this reason, these acquisitions in question are built in the price of the goods and products of the taxpayer as a consequence input VAT may be also deducted. The condition of the direct and prompt relationship between the

[13] C-435/05 Investrand BV kontra Staatssecretaris van Financiën, dated: 8 February 2007, issued by ECJ.

[14] C-110/94 Intercommunale voor zeewaterontzilting (INZO) kontra Belgische Staat, dated: 29 February 1996, issued by ECJ.

[15] C-32/03 I/S Fini H kontra Skatteministeriet, dated: 3 March 2005, issued by ECJ.

[16] C-465/03 Kretztechnik AG és a Finanzamt Linz, dated: 26 May 2005, issued by ECJ.

acquisition and the business activity of the taxpayer is granted in this case.

However, several question arises in case of office equipment – being the general costs of taxpayers. Generally, it is very difficult to determine whether this equipment serves the taxable business activity of the taxpayers or not. Based on the Hungarian practice, VAT may not be deducted in case of office equipment, which unambiguously serves the private needs of the employees except protective drinks.

We should also examine one of the most important conditions of VAT deduction right: an invoice issued to the name of customer, which should be in line with the requirements set forth by the Hungarian legislation.

However, ECJ reached the conclusion in case Genius Holding[17] that an invoice in itself should not establish the right of VAT deduction. The performed sale of service / good itself should be examined based on which it should be determined whether the VAT deduction right exists or not. However, ECJ empathised that in several cases (Gabalfrisa SL and Others and Agencia Estatal de Administración Tributaria) that the national legislation may not prescribe additional requirements in order to assess the VAT deduction right (e.g. additional declaration from the taxpayer regarding its deduction right).

Problems regarding free of charge transactions

Taxpayers are generally think that input VAT may not deducted in case of free of charge transactions, however, the general rules should be applied in these cases either. This means that it should be examined first whether the acquisition serves the taxable business activity of the company or not. A relevant decision was issued in case Kuwait Petroleum[18] in this regard. Kuwait Petroleum Ltd. sold fuel to private individuals in its own and in its business partners' fuel stations. Kuwait Petroleum organised a sales promotion based on which customers get voucher after every 12 litres of fuel. The price of the fuel was independent from the fact that the customer accepted the voucher or not. After a definite number of vouchers the customers might choose products from a catalogue or 'buy' services. Kuwait Petroleum deducted input VAT in relation to these products and services. However, the tax authority stated that 'buying' products with the vouchers should also create VAT payment obligation. Kuwait Petroleum stated that the price of the products and services was incorporated in the price of the fuel and paid by the participants of the promotion. ECJ reached the conclusion that the promotion served the taxable business purposes of Kuwait Petroleum therefore it has the right to deduct input VAT.

However, the above case should be differentiated from the VAT treatment of donation for public purposes, low-value gifts and samples. These transactions should not be considered as sale of goods for consideration. In these cases, we should apply the general rules either, i.e. it should be determined whether the transactions served the taxable business activity of the taxpayer.

5. VAT deduction right in case of VAT proportionate

VAT proportioning is necessary if the acquired goods or services serve both the taxable and VAT exempt business purposes of the taxpayer. If the acquisition serves partly non-business purposes, taxpayers have two options: deducting the whole

[17] C-342/87 Genius Holding BV kontra Staatssecretaris van Financiën, dated: 13 December 1989, issued by ECJ.
[18] C-581/12 Kuwait Petroleum and Others v Commission, dated: 21 November 2013, issued by ECJ.

amount of input VAT or do not deduct input VAT at all. There is no straight answer for that which option should be generally applied. The VAT deduction right should be analysed on a case by case bases.

In case C-434/03. (P. Charles and T. S. Charles-Tijmens contra Staatssecretaris van Financiën) ECJ had to decide in that if the taxpayer buys premises for either private and lease purposes, VAT may be deducted or not. The Dutch Tax Authority stated that, taking into account the private use of the premises the taxpayer did not have VAT deduction right as it did not serve the taxable business activity of the taxpayer. Based on the opinion of ECJ, if tangible assets are used for both private and business purposes the taxpayer should decide whether the asset should be considered as (1) a business asset, (2) a private asset (in this case the use of the asset falls outside of the scope of VAT) or alternatively (3) proportionate the asset. In the first case, the taxpayer has VAT deduction right provided that the general conditions of VAT deduction are fulfilled. However, in this case the taxpayer should pay VAT (as the use of asset for private purposes should be considered as a taxable transaction based on the Directive). In the second case, the taxpayer is not entitled to deduct input VAT; however, it is not obliged to pay VAT after the private use. In the case in question the taxpayer applied, the first case therefore was entitled to deduct input VAT. In some cases, option (3) should be applied such as in case C-291/92. (Finanzamt Uelzen contra Dieter Armbrecht). ECJ empathized that the Directive does not contain any restriction considering this option; only the correct ratio should be determined and applied.

VAT deduction right in case of transactions falling outside of the scope of VAT

These transactions should not be considered as sale of goods or services therefore fall outside of the scope of VAT. However, this fact should not mean that input VAT might not be deducted. For example there are some transactions which are excluded from the scope of VAT e.g. transfer of going concern in which cases the general rule should be applied (i.e. whether it serves the taxable business activity of the taxpayer).

Based on the currently applicable regulation, community transactions consist of two transactions: a VAT exempt sale in the country of dispatch and a taxable acquisition in the country of destination. In this system, local VAT rate should be applied (i.e. country of destination).[19] VAT may be deducted in the month of determination of payable VAT which should be the date indicated on the certificate of completion or the 15th day of the month following the actual performance. There is a simplification in such reverse charge transactions based on case Gerhard Bockemühl C-90/02. In the case of reverse charge transactions taxpayers may deduct input VAT even if they did not receive the respective invoice which is a condition of VAT deduction.

Contrary to the above simplification, there are additional requirements in case of import of goods. The reason of the strict requirements is that import VAT should not be assessed if the goods enter into the country physically. Import VAT should be paid only if the goods are released into free circulation and the customs authority issues a certificate in this regard.

Summary

Considering the above, we can say that VAT is called as the queen of taxes for

[19] https://www2.deloitte.com/hu/hu/pages/ado/articles/jelentos-valtozasok-az-afa-rendszerben.html.

several reasons and the relevance of this type of tax is constantly increasing. According to the European Commission, Member States lost 150 billion euro value added tax due to tax frauds from which Hungary lost approx. 1.6 billion euro. This amount is considered as low taking into account the numbers of former years. [20]

The three most common ways in case of VAT frauds are related to fictive transactions: absence of economic transaction, not proper business partner and frauds during chain transactions. The first type should be examined by the tax authorities, however, sometimes it is challenging when the proper documentation (contract and invoices) is prepared. In the second type, the tax authorities should examine whether the taxpayer knew or should have known that its business partner was involved in tax fraud.[21]

The most common questions arise regarding the complex requirements of VAT deduction, which has two main essentials: the existence of VAT deduction right and certain objective requirements. The first essential depends on the taxable status of the company and the business activity. The second essential should generally mean the invoice regarding the transaction (and the mentioned certificate in case of import as well as the monitoring of business partners).

The above questions are the most common subjects in the procedures before ECJ. However, it should be also noted that the national courts usually questions the second essential while ECJ generally examines the first essential. Based on this, it should be concluded that ECJ provides assistance primarily in conceptual questions (for example the definition of the used phrases) but no in operative questions.[22] For example, ECJ considered preparatory and disposal activities as part of the business activity.

Based on the practice of ECJ the VAT deduction right should not be restricted generally and tax authorities should have objective evidence in order to be able to reject the VAT deduction right.

There are some outstanding questions however, which should be cleared. One of these questions is the requirement of monitoring of business partners. The exact requirements should be determined either by the community or by the national legislation.

As a conclusion, we can say that both the Hungarian authorities and the taxpayers are paying attention to the decisions of ECJ and trying to operate in line with these rules.

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[22] Dr. Erdős Éva: Az általános forgalmi adóztatás jogi alapjai és lehetséges fejlesztési irányai, in Összefoglaló vélemény, Kúria Közigazgatási-Munkaügyi Kollégium Joggyakorlat-elemző Csoport 2014.El. II.JGY.1/2., 2016.június 6-án jóváhagyott összefoglaló véleménye. levonásos ítéletei, 226.oldal, Európa Unió Bírósága számlázási ítéletei 255.oldal https://kuria-birosag.hu/sites/default/files/joggyak/osszefoglalo_velemeny.afa_.pdf letöltés dátuma: 2019.05.05.

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