Case C-334/20

Request for a preliminary ruling

Date lodged:

23 July 2020

Referring court:

Veszprémi Törvényszék (Veszprém Court, Hungary)

Date of the decision to refer:

20 July 2020

Applicant:

Amper Metal Kft.

Defendant:

Nemzeti Adó- és Vámhivatal Fellebbviteli Igazgatósága (Resources Directorate of the National Tax and Customs Authority, Hungary)

[…]

The Veszprémi Törvényszék (Veszprém Court)

[…]

In the administrative-law tax proceedings brought by **Amper Metál Kft.** ([…] Dunaújváros, Hungary […]), **the applicant**, against the **Nemzeti Adó- és Vámhivatal Fellebbviteli Igazgatósága** (Resources Directorate of the National Tax and Customs Authority, Hungary) ([…] Székesfehérvár, Hungary […]), **the defendant**, the Veszprém Court issues the following

Decision

This court […] refers the following questions to the Court of Justice of the European Union for a preliminary ruling:

1. Must, or may, Article 168(a) of Council Directive 2006/112/EC of 28 November 2006 on the common system of value added tax ('the VAT Directive') be interpreted as meaning that, under the said provision, in view of its use of the expression 'are used', the right to deduct VAT cannot be refused in

respect of a transaction that falls within the scope of the VAT Directive on the grounds that, in the opinion of the tax authorities, the service provided by the person issuing the invoice in the course of a transaction between independent parties is not 'beneficial' to the taxable activities of the recipient of the invoice, in that:

– the value of the service (advertising) provided by the person issuing the invoice is disproportionate to the benefit (sales revenue/increase in sales revenue) which the service generates for the recipient; or

– the said service (advertising) has not generated any sales revenue for the recipient?

2. Must, or may, Article 168(a) of the VAT Directive be interpreted as meaning that, under this provision, the right to deduct VAT may be refused in respect of a transaction that falls within the scope of the VAT Directive on the grounds that, in the opinion of the tax authorities, the service provided by the person issuing the invoice in the course of a transaction between independent parties is for a disproportionate sum, because the service (advertising) is expensive and the price is excessive in comparison with another service or services?

[…] [procedural considerations of domestic law]

Grounds

Facts

Proceedings before the first-tier tax authority and the decision given

The Nemzeti Adó- és Vámhivatal Fejér Megyei Adó- és Vámigazgatósága (Tax and Customs Directorate for the county of Fejér, part of the National Tax and Customs Authority, Hungary; 'the first-tier tax authority') carried out an *ex post* verification of the VAT returns for the tax period from 1 January to 31 December 2014, as a result of which it issued a decision […] ('the first-tier decision') in which it assessed the applicant, as the taxable person, as being liable for a difference in VAT amounting to HUF 12 960 000, the entire amount of which was deemed to be a tax debt. It therefore imposed a tax penalty and late-payment surcharge of HUF 3 240 000 and HUF 868 000 respectively on the applicant, and issued a demand for payment of all the sums in question.

In the grounds for its decision, the first-tier tax authority stated, with regard to the facts of the case, that the applicant had included as expenditure the amounts recorded in 12 invoices issued by Sziget-Reklám Kft. in 2014, each of which was for a net amount of HUF 4 000 000 and a gross amount of HUF 5 080 000 once VAT at 27% had been added, and that it had deducted the corresponding amount of VAT.

According to the services and cooperation agreement supplied to the tax inspectorate by the applicant, the service provider, Sziget-Reklám Kft, undertook to place displays measuring 30 x 10 cm advertising the client, that is, the applicant, on both sides of the race car driven by a participant entered in the races in the 2014 season of the Magyar Gyorsasági Bajnokság [a race competition in Hungary] by a contractual partner of the service provider. The price of the service for the entire term of the contract was HUF 48 000 000 plus VAT, which was settled by the parties periodically.

Based on the documents in the criminal file supplied by the Nemzeti Adó- és Vámhivatal Dél- Dunántúli Bűnügyi Igazgatósága (Criminal Cases Directorate for Southern Transdanubia, part of the National Tax and Customs Authority, Hungary), which included reports from forensic tax and duty experts and advertising specialists obtained during the criminal investigation, in summary, the first-tier tax authority reached the following conclusions concerning the services and cooperation agreement between the applicant and Sziget-Reklám Kft. which was the subject of the invoices:

– The payment of HUF 48 000 000 plus VAT is disproportionately high, given that the same service has also been purchased for a lower price.

– The contract is fraudulent, since the service provided barely amounts to a genuine service.

– The contract sum is also disproportionately high because the expenditure does not generate any publicity value or commercial return; the applicant could have achieved the actual publicity value at far less expense.

– Experts are able to pinpoint possible customers or clients from among potential commercial partners, namely paper factories, hot lamination workshops and other industrial plants; and if they cannot identify them, no type of advertising will solve the problem, since customers do not base their decisions on advertisements displayed on cars but on factors such as price, quality, delivery time or flexible payment terms. It could therefore have been predicted that the expenditure in question would generate losses and could not be expected to improve business results.

Having regard to the points set out above, and based on the expert opinions, the first-tier tax authority found that the advertising on racing cars for which Sziget-Reklám Kft. invoiced the applicant does not constitute expenditure in connection with the applicant’s taxable income-generating activities.

In reaching its conclusion, the first-tier tax authority relied on the following statutory provisions:

Article 119(1) of the az általános forgalmi adóról szóló 2007. évi CXXVII. törvény (Law CXXVII of 2007 on Value Added Tax'; 'the VAT Law'), which establishes that, unless otherwise provided for in the VAT Law, a right to deduct the tax arises at the time the amount due in respect of input tax is to be determined (Article 120), even where the tax due is calculated in accordance with Article 196/B(2)(a).

Article 120(a) of the VAT Law, which establishes that, in so far as the taxable person, acting as such, uses or otherwise exploits goods or services in order to carry out a taxable supply of goods or services, he is entitled to deduct from the tax that he is liable to pay the amount of tax he was charged, in connection with the purchase of the goods or the use of the services, by another taxable person – including any person or entity subject to simplified corporation tax.

Article 8(1)(d) of the a társasági adóról és az osztalék adóról szóló 1996. évi LXXXI. törvény (Law LXXXI of 1996 concerning tax on companies and dividends; 'the Law on Tax on Companies and Dividends'), which establishes that profit before tax is to be increased by the amounts of any expenditure or costs by which the profit has been reduced — including depreciation of intangible and tangible fixed assets — that are not related to business or income-generating activities, having regard in particular to the provisions of Annex 3.

Pursuant to point 4 of Annex 3 to the Law on Tax on Companies and Dividends, [for the purposes of Article 8(1)(d), the following, inter alia, will not be deemed expenditure or costs incurred for the benefit of business activities:] payment (whether total or partial) for a service that exceeds HUF 200 000, excluding VAT, where it can clearly be concluded on the basis of the circumstances (such as, in particular, the taxable person's business activities, his turnover, the nature of the service or the payment for the said service) that use of the service is contrary to the requirements of reasonable management; payments received during a single financial year for services of the same kind from the same person are to be treated jointly.

With regard to the last of these statutory provisions and the definition of reasonable management, the first-tier tax authority noted that the Law on Tax on Companies and Dividends does not define this concept, and therefore the content of the requirement has to be inferred from the relevant case-law. The interpretation of the requirement for reasonable management under tax law is not precisely the same as the content of the same fundamental principle under civil law, which has also been developed by case-law. According to tax case-law, in order to demonstrate reasonable management and a connection with income-generating activities, two conditions must be shown to be satisfied:

– First and foremost, it must be demonstrated that the economic transaction to which the payment relates actually took place, and also that the specific service in question, and thus the payment of the

corresponding consideration, are related to the taxable person's business or income-generating activities.

– Secondly, the question of whether the expenditure incurred was manifestly and disproportionately excessive must also be examined.

In this regard, the first-tier tax authority found that the stickers — that is to say, the advertisements — were actually placed on the racing cars taking part in the car race, but that — as is clearly confirmed by the experts' concurring opinions — the transaction did not produce any benefit for the applicant and is therefore not connected with its income-generating activities. Moreover, the consideration paid for the advertising service received by the applicant far exceeded the usual market price, and was therefore deemed to be contrary to the requirements of reasonable management.

In the light of these considerations, the first-tier tax authority ruled that the service that was treated as expenditure was not reasonable from a financial standpoint, could not be connected to the applicant's business or income-generating activities, and, according to the expert reports, had no publicity value; consequently, under the statutory provisions cited above, the VAT in the invoices for the said service is not deductible. In the light of the information available to it, the first-tier tax authority therefore found that the applicant, as the taxable person, had incorrectly deducted the VAT included in the invoices issued by Sziget-Reklám Kft., and consequently, under Article 120(a) of the VAT Law, it was not entitled to deduct the VAT charged to it in invoices for a service that had no value in terms of income generation.

The first-tier tax authority therefore assessed the applicant as being liable for the VAT it had included in its tax return as deductible input VAT charged on the service it had received from Sziget-Reklám Kft., because the authority deemed the VAT to have arisen under invoices issued for expenditure that was not for the benefit of the company.

Proceedings before the second-tier tax authority and the decision given

Following an administrative-law appeal by the applicant, the defendant, acting as the second-tier tax authority, upheld the decision given by the first-tier authority […] on 9 January 2019 ('the second-tier decision').

According to the grounds for the second-tier decision, the first-tier tax authority was correct in finding that the applicant, as the taxable person, had incorrectly deducted the VAT included in the disputed invoices issued by Sziget-Reklám Kft., since the expert opinions clearly confirmed that the management with regard to the purchase of that service was not reasonable. Consequently, under Article 120 of the VAT Law, the applicant was not entitled to deduct the input VAT charged to it in invoices for a service that had no value in terms of income generation. Therefore, in the opinion of the second-tier tax authority, the first-tier decision

cannot be considered to be contrary to law in so far as that decision assessed the applicant as being liable for the VAT it had included in its tax return as deductible input VAT included in the invoices from Sziget-Reklám Kft., which were issued in respect of expenditure that had not been incurred for the benefit of the company.

Purpose of the administrative-law appeal

In its administrative-law appeal, the applicant is asking for the first and second-tier decisions to be declared contrary to law and for both decisions to be annulled. It is challenging both decisions in their entirety as regards both the legal basis and the amounts involved.

In its opinion, the factors taken into account by the defendant — namely, that its advertising expenditure is not reasonable, does not generate any commercial return, has no real publicity value and cannot be classed as income-generating activity — have absolutely no bearing on the right to deduct VAT, because such an approach bears no relationship to the fundamental principles on which the system of value added tax is based.

On this issue, with regard to the right to deduct tax, it relies on various judgments of the Court of Justice of the European Union: the judgment in Case C-107/10 (*Enel Maritsa Iztok 3*), paragraph 32; the judgment in Case C-324/11 (*Tóth*), paragraphs 23, 24 and 25; and the judgment in Case C-376/02 (*'Goed Wonen'),* paragraph 26.

It also places particular reliance on the judgment in Case C-317/94 (*Elida Gibbs*), citing paragraphs 26 and 27 and also noting that the observations made in this judgment have been confirmed in several other judgments of the Court of Justice (such as those in Case C-285/10, paragraph 28, and in joined Cases C-249/12 and C-250/12, paragraph 33). In view of the content of those judgments, it considers there can be no doubt that the taxable amount is the consideration actually received by the vendor under a specific transaction; in other words, the defendant is incorrectly relying on 'disproportionate value' as grounds for refusing the right to deduct.

It points out that, according to paragraphs 43 and 44 of the judgment in Case C-118/11, the common system of VAT seeks to ensure complete neutrality of taxation of all economic activities, whatever their purpose or results, provided that they are themselves subject, in principle, to VAT.

In addition to these judgments it also refers to the paragraphs it cites from the judgments in the following cases: Case 230/87 (*Naturally Yours Cosmetics*), paragraph 16; Case 154/80 (*Coöperatieve Aardappelenbewaarplaats*), paragraph 13; Case C-126/88 (*Boots Company*), paragraph 19; Case C-258/95 (*Fillibeck*), paragraph 13; Case C-404/99 (*Commission* v *France*), paragraph 38;

Case C-412/03 (*Hotel Scandic Gåsabäck*), paragraph 21; and joined Cases C-621/10 and C-129/11 (*Balkan and Sea Properties*), paragraphs 43 and 44.

In the light of the above, the applicant considers that the right to deduct VAT can also be exercised where the expenditure paid out by the taxable person was neither reasonable nor economically efficient. It notes that in the present case the tax was passed on, since it paid Sziget-Reklám Kft. the tax charged by the supplier in its invoices by bank transfer. It states that its right to deduct the tax is enshrined in Article 119(1) of the VAT Law, under which the right to deduct arises at the time the amount due in respect of input tax is to be determined (Article 120).

In its opinion, the requirement in Article 120(a) of the VAT Law to 'otherwise exploit[s]' — which means that the right to deduct can be exercised only where the service purchased gives the taxable person a benefit that can be demonstrated in terms of numbers in budget lines — is clearly contrary to EU law, and therefore, in accordance with the principles of the primacy of EU law and the approximation of laws, it constitutes an additional requirement that cannot apply.

The defendant's arguments

In its response, the defendant requests that the administrative-law appeal be dismissed, and repeats the legal position set out in the grounds for the decision challenged in the appeal.

The defendant continues to believe that the expenditure prompted by the invoices censured by the tax authority is manifestly and disproportionately excessive, and that the service recorded as an expense is not reasonable in financial terms, cannot be related to business or income-generating activities and, according to the expert opinions, has no publicity value. On this point it notes that, having considered the applicant's income statements over several financial years, the type and local nature of the service provided by the company in the market and the image projected by the company on its website, the experts involved in the investigation concluded that the applicant's potential commercial partners are unlikely to buy consumer goods on the basis of emotional decisions. The applicant operates in the electrical installation sector, and contracts for larger-scale projects will not be awarded on a non-professional basis. When selecting a commercial partner, the factors influencing the decision are price, payment terms and delivery conditions. In the applicant's case, the results do not suggest that the expenditure produced any benefit either, and therefore both expert opinions concluded that displaying the applicant's name on stickers on the sides of vehicles taking part in motor races was of no value.

The defendant therefore believes that it has not breached the fundamental principle of the system of value added tax, since the circumstances it refers to in the administrative-law appeal — the unreasonable nature, the absence of any publicity value and the lack of any connection with income-generating activities — are indeed relevant when assessing the unlawfulness of the deduction.

It therefore considers that the applicant's argument that the right to deduct VAT can also be exercised where the taxable person's expenditure is not reasonable or economically efficient is completely wrong. It emphasises that the lack of any economic rationale prevents the exercise of the right to deduct VAT and that the unrealistic consideration also makes the content of the invoice implausible. In order for the deduction to be lawful, there must be an immediate and direct connection between the purchase and the taxable business activities, and where there is no such connection there is no right to deduct.

The defendant also notes that Article 80(1) of the VAT Directive unequivocally and exhaustively lays down the conditions that must be satisfied in order for a Member State to be able to make provision in its legislation for the taxable amount of a transaction to be corrected. All of this means that where the taxable amount is not genuine, Member States' legislation may make adjustments to the taxable amount recorded in the invoice, as was done in the present case.

Legislative framework

1. EU law

Article 168(a) of the VAT Directive, which establishes that in so far as the goods and services are used for the purposes of the taxed transactions of a taxable person, the taxable person is entitled, in the Member State in which he carries out these transactions, to deduct from the VAT which he is liable to pay the VAT due or paid in that Member State in respect of supplies to him of goods or services, carried out or to be carried out by another taxable person.

Article 80(1) of the VAT Directive: 'In order to prevent tax evasion or avoidance, Member States may in any of the following cases take measures to ensure that, in respect of the supply of goods or services involving family or other close personal ties, management, ownership, membership, financial or legal ties as defined by the Member State, the taxable amount is to be the open market value:

(a) where the consideration is lower than the open market value and the recipient of the supply does not have a full right of deduction under Articles 167 to 171 and Articles 173 to 177;

(b) where the consideration is lower than the open market value and the supplier does not have a full right of deduction under Articles 167 to 171 and Articles 173 to 177 and the supply is subject to an exemption under Articles 132, 135, 136, 371, 375, 376, 377, 378(2), 379(2) or Articles 380 to 390b;

(c) where the consideration is higher than the open market value and the supplier does not have a full right of deduction under Articles 167 to 171 and Articles 173 to 177.

For the purposes of the first subparagraph, legal ties may include the relationship between an employer and employee or the employee's family, or any other closely connected persons.'

2. Hungarian law

Legal provisions already cited above in the section on the facts:

Article 119(1) of the VAT Law, under which, unless otherwise provided for in the VAT Law, a right to deduct the tax arises at the time the amount due in respect of input tax is to be determined (Article 120), even where the tax due is calculated in accordance with Article 196/B(2)(a).

Article 120(a) of the VAT Law, which establishes that, in so far as the taxable person, acting as such, uses or otherwise exploits goods or services in order to carry out a taxable supply of goods or services, he is entitled to deduct from the tax that he is liable to pay the amount of tax he was charged, in connection with the purchase of the goods or the use of the services, by another taxable person – including any person or entity subject to simplified corporation tax.

Article 8(1)(d) of the Law on Tax on Companies and Dividends, pursuant to which profit before tax is to be increased by the amounts of any expenditure or costs by which the profit has been reduced — including depreciation of intangible and tangible fixed assets — that are not related to business or income-generating activities, having regard in particular to the provisions of Annex 3.

Point 4 of Annex 3 to the Law on Tax on Companies and Dividends: For the purposes of Article 8(1)(d) the following, inter alia, will not be deemed expenses or costs incurred for the benefit of business activities: payment (whether total or partial) for a service that exceeds HUF 200 000, excluding VAT, where it can clearly be concluded on the basis of the circumstances (such as the taxable person's business activities, his turnover, the nature of the service or the payment for the said service) that use of the service is contrary to the requirements of reasonable management; payments received during a single financial year for services of the same kind from the same person are to be treated jointly.

Reasons for the questions referred by the referring court

As the applicant has said, these proceedings revolve around the answer to the question of whether a taxable person who is solely carrying on a taxable activity is entitled to deduct only where he can prove the 'benefit' of the service provided to him (in this case, an advertising service), and can back it up with specific objective information,

According to the referring court, this question assumes particular importance in the present case when one considers also that, with regard to the right of deduction, Article 168(a) of the VAT Directive refers only to the expression 'are

used', whereas, by contrast, in addition to the term 'uses', Article 120(a) of the VAT law also includes the expression 'otherwise exploits' and, in Hungarian, exploitation means usage that produces results, that is, effective and profitable use.

In the light of the above, in order to reach a decision in the proceedings the following question must in any event be answered: whether, with regard to the right to deduct the tax, the concept of 'use' as it appears in the VAT Directive must be understood to include the generation of a profit and a demonstrable return — and, thus, a benefit; in other words, whether these elements are essential in order for there to be 'use' within the meaning of Article 168(a) of the VAT Directive. The interpretation of EU law requested by the referring court therefore relates to the circumstances and subject matter of the main proceedings.

The judgments of the Court of Justice cited by the applicant, or the parts of those judgments cited by it, do not specifically refer to this issue or have a bearing on it. Paragraph 32 of the judgment in Case C-107/10 states that the right to deduct is exercisable immediately in respect of all the taxes charged on transactions relating to inputs; in essence, the same point is made in paragraph 24 of the judgment in Case C-324/11, which addresses the principle of tax neutrality. Likewise, paragraph 26 of the judgment in Case C-376/02 and paragraph 43 of the judgment in Case C-118/11 also deal with the principle of tax neutrality. By contrast, the judgments in Cases C-317/94 (*Elida Gibbs*) and C-285/10, in joined Cases C-249/12 and C-250/12, in Case C-412/03 and in joined Cases C-621/10 and C-129/11 dealt with the taxable amount, which they held to be subjective. (For their part, in view of the dates of the judgments — 5 February 1981, 23 November 1988, 27 March 1990, 16 October 1997 and 29 March 2001 — the judgments in Cases 154/80, 230/87, C-126/88, C-258/95 and C-404/99, naturally, do not affect the VAT Directive.)

Therefore, in the view of the referring court, the replies to the questions referred in this decision cannot be clearly inferred from the judgments cited by the applicant, given that the subject matter of the proceedings is different.

In the light of all of the above, the referring court has concluded that in order to rule on the proceedings, it needs to refer the matter to the Court of Justice for a preliminary ruling […] [procedural consideration of domestic law].

Veszprém, 20 July 2020

[…] [signatures]