CJEU ruling on reverse charge VAT (1/18/17)

The reverse charge procedure is usually deployed to fight VAT fraud. Latvia has already adopted this procedure for six types of transactions, and there are plans to cover more. However, tax experts say that in certain industries (such as construction) the areas where reverse-charge VAT should be applied are not clearly defined, and so the taxpayers face the risk of additional VAT assessment should the State Revenue Service (SRS) find that the procedure has been applied incorrectly. Since we are aware of such disputes with the SRS, this article explores ruling C-564/15 made by the Court of Justice of the European Union (CJEU).

The facts and questions of the case

Tibor Farkas, a Hungarian entrepreneur, bought a mobile hangar from a limited company with a tax debt at an online auction organised by the tax authority. The seller invoiced this supply with VAT under the general procedure and remitted the VAT to the tax authority. The VAT invoiced and paid to the seller was deducted by the entrepreneur on his VAT return. However, the tax authority claimed that the entrepreneur had failed to comply with the reverse charge rules of the VAT Act, under which the buyer should pay VAT directly to the government. Accordingly, the tax authority made a decision that was unfavourable to the entrepreneur, as well as assessing a VAT debt and a 50% penalty.

The Hungarian court, to whom the tax dispute was referred, suspended the litigation and put two preliminary questions to the CJEU:

1. Is the administrative approach under which the tax authority assesses VAT where the seller issues an invoice under the general procedure for a supply covered by the reverse charge procedure, then reports and remits the invoiced VAT to the government, and the buyer deducts the input VAT paid to the seller, compatible with the provisions of Directive 2006/112/EC (the VAT directive)?
2. Is the penalty imposed in the case of a VAT difference for selecting the incorrect form of payment, which includes a penalty equal to 50% of the difference, proportionate if no tax revenue has been lost and there is no evidence of abuse of the VAT system?

CJEU considerations and ruling

Firstly, the CJEU stated that the clause of the Hungarian VAT Act, which provides for applying the reverse charge procedure to both movable and immovable property sold at auctions, is not consistent with article 199(1)(g) of the VAT directive, which is restricted to supplies of immovable property at auctions. Accordingly, the Hungarian court should determine whether the mobile hangar in the tax dispute is movable property or immovable property.

Secondly, in reply to the first question asked by the Hungarian court, the CJEU stated that the provisions of the VAT directive as well as the principles of fiscal neutrality, effectiveness and proportionality should be interpreted to the effect that they are not infringed by the fact that in the situation examined in the main proceedings the buyer is denied the right to deduct input tax he paid to the seller incorrectly on the basis of an invoice issued under the general procedure for a supply that attracts reverse-charge VAT if the seller has remitted the VAT to the government. These principles require, however, that where it becomes extremely difficult or impossible for the seller to refund the VAT incorrectly shown on the buyer’s invoice, in particular when the seller goes into insolvency, the buyer may claim a refund directly from the tax authority.

Thirdly, the CJEU stated that the principle of proportionality is infringed by the fact that in the situation

examined in the main proceedings the tax authority imposes a penalty on the taxpayer equal to 50% of the amount of VAT he has to pay to the government if no tax revenue has been lost and there is no evidence of abuse of the VAT system to be examined by the Hungarian court.

The conclusion

Given the principles of fiscal neutrality, effectiveness and proportionality invoked by the CJEU, where no abuse of the VAT system has been found but the tax authority has assessed additional VAT or denied the right to deduct input tax, the taxpayers should be given the opportunity to make appropriate adjustments to their tax invoices and VAT returns in order to ensure that VAT on a single supply is not paid to the government twice.

For example, a taxpayer has carried out some building work and applied reverse-charge VAT, but the SRS claims that this procedure has been applied incorrectly and assesses the builder to additional VAT, even though the customer has accounted for reverse-charge VAT (or remitted the VAT to the government because he is not allowed to deduct input tax, e.g. a bank or a gaming business). We believe that in this case the SRS should allow (a) the supplier to adjust his invoices and (b) the customer to adjust his VAT returns.