Euro Tax Flash from KPMG's EU Tax Centre

[CJEU decision on Hungarian advertisement tax]

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CJEU decisions on progressive tax on turnover and fines related to advertising tax

Freedom to provide services – Hungary – Advertisement tax – Special tax on certain sectors – State aid – Freedom of establishment

On March 3, 2020, the Court of Justice of the European Union (CJEU) rendered its decisions in three cases, (C-482/18), (C-323/18) and (C-75/18), each of which concerned aspects of Hungarian law. The CJEU decided that the EU freedom of establishment does not preclude Member States from levying a progressive tax on turnover, the actual burden of which is mainly borne by companies controlled from another Member State.

The Court also ruled that Hungarian advertisement tax penalty regime disproportionately affected companies located in another EU Member State and was therefore contrary to the EU principle of freedom to provide services.

Hungarian advertisement tax case – (C-482/18)

Background

Hungarian law introduced a tax on advertisements that were published in Hungarian or mainly on internet pages that are in Hungarian. Companies within the scope of the tax were required to register with the Hungarian tax authorities within 15 days of commencing the relevant advertising activity. For Hungarian registered businesses, the registration requirements were more straight-forward with companies, in most cases deemed to automatically satisfy the registration requirements based on existing registration for other purposes.

The taxpayer in this case was an internet service provider that did not have a physical presence in Hungary. The Hungarian tax authorities imposed an initial fine of approximately

EUR 30,000 on the taxpayer for failing to comply with its registration obligations, a penalty which increased on a daily basis and ultimately reached approximately EUR 3million.

The taxpayer contested the decision of the Hungarian tax authorities, arguing that the different registration systems applicable to domestic and foreign taxpayers, the increased level of penalties suffered by foreign companies for failing to register for the tax and the limited redress available constituted a restriction on the freedom to provide services and was therefore contrary to EU law.

CJEU decision

The CJEU first noted that it was not asked to rule on whether the liability to a tax on online advertisements represents a restriction on the freedom to provide services, but only if the obligation imposed on suppliers of advertising services to submit a declaration for the purposes of that tax represents such a restriction.

The Court ruled that the imposition of a reporting obligation, which is an administrative formality, should not per se constitute an obstacle to the freedom to provide services. In this regard, the EU free movement of services was found to not preclude legislation in a Member State which requires a non-Hungarian established service provider to register and complete a declaration where domestic providers of the same advertising services are exempt as they are already registered with the Hungarian tax authorities in respect of a different tax. In this respect, the Court noted that non-resident suppliers are also exempt from the obligation to submit a tax declaration if they have already submitted a declaration or registered with the tax authority for the purposes of another tax levied in Hungary. The Court further noted that the exemption from the obligation to submit a tax declaration does not have a deterring effect on the cross-border supply of advertising services, but rather prevents suppliers already registered with the tax authority from being required to complete an additional administrative formality. It was also observed that the administrative burden did not appear to be more onerous for non-Hungarian suppliers compared to domestic suppliers.

In relation to the special penalties imposed for failing to register for the Hungarian tax on advertisements, the Court noted that sanction regimes in tax matters typically fall within the competence of individual EU Member States. While the sanctions in this case were, in the first instance, applicable to both domestic Hungarian and non-domestic companies, the Court determined that it was likely that domestic Hungarian companies would be penalized under the general provisions of Hungarian tax law and would be subject to less stringent penalties as a result. The CJEU concluded that this difference in treatment was contrary to the freedom to provide services. The Court also found that the restriction was not justified on the grounds of the need to ensure the effectiveness of fiscal supervision and the effective collection of tax, citing the disproportionate manner – no link between the exponential increase of the penalty and the seriousness of the failure, not taking into account turnover (the basis of assessment of the tax), and short timeframe in which the fines were imposed.

On the basis that a restriction of the freedom to provide services had already been established, the Court declined to address whether the specific legal redress against the penalties represented an unjustified restriction on the freedom to provide services.

Hungarian progressive tax on store retail trade – (C-323/18)

Background

The case relates to a special tax on certain sectors that was chargeable, inter alia, on taxable persons involved in retail store trade and imposed using a progressive rate structure ranging from 0% to 2.5%. The taxpayer argued that the imposition of the special tax was contrary to EU law. In this regard, the referring court asked the CJEU to consider whether it constituted discrimination if a taxable person that engages in store retail trade through a number of retail establishments has to pay a higher rate of the special tax when compared against independent, and generally domestic, companies which operate through a franchise, are exempt from the tax. The referring court also asked whether the application of the special tax could represent illegal State aid.

CJEU decision

The CJEU noted that the freedom of establishment prohibits direct or indirect discrimination based on the location of the seat of a company.

The Court therefore examined whether the use of a progressive tax rate to impose different levels of taxation on companies represents either direct or indirect discrimination. The Court noted that the disputed tax makes no distinction between taxpayers based on where they have their registered office and therefore does not establish direct discrimination. The Court further noted that the application of a system of progressive taxation is within the power of each Member State and that progressive taxation can be based on turnover on the basis that turnover represents a criterion of differentiation that is neutral and a relevant indicator of a taxable person's ability to pay. The CJEU also stated that the fact that companies owned predominantly by foreign shareholders are taxed more heavily is not sufficient to demonstrate that discrimination exists, as the higher rate of tax suffered is due to the fact that these companies are generating the most significant turnover in the market. The Court therefore found no evidence of indirect discrimination and therefore no restriction of the freedom of establishment.

In relation to the State aid questions, the Court recalled that if an exemption from tax is unlawful that does not affect the lawfulness of the actual charging of that tax. As such, taxpayers may not rely on the argument that the exemption enjoyed by other persons constitutes State aid in order to avoid payment of that tax. The position is different where the dispute concerns the legality of the rules relating to that tax, rather than an application for exemption. The Court noted that taxes do not fall within the scope of the provisions of the Treaty on the Functioning of the EU (TFEU) concerning State aid unless they constitute the method of financing an aid measure, so that they form an integral part of that measure. For a tax to be regarded as forming an integral part of an aid measure, it must be hypothecated to the aid measure under the relevant national rules.

In this case, the Court found, however, that the burden imposed on the applicant companies concern general taxes, the revenue from which is transferred to the State budget, those taxes not being specifically allocated to the funding of a tax advantage for which a particular category of taxable persons qualify. The Court concluded that the special taxes imposed on those applicant companies are not hypothecated to the exemption for which some taxable persons qualify, and consequently any illegality under EU rules relating to State aid of such an

exemption is not capable of affecting the legality of those special taxes themselves. Accordingly, the Court ruled that applicant companies cannot rely, before the national courts, on that possible illegality in order to avoid payment of those taxes.

Hungarian special tax on telecommunications – (C-75/18)

Background

The case relates to a special tax on certain sectors that was chargeable, inter alia, on taxable persons involved in telecommunication services and imposed using a progressive rate structure ranging from 0% to 6.5%. The taxpayer argued that the imposition of the special tax was contrary to EU law. In its submission, the referring court highlighted that application of the special tax, in practice, led to a scenario in which only foreign-owned subsidiaries were more likely to be subject to the higher rate of tax than domestic Hungarian businesses. Following that, the referring court questioned (i) whether the special tax constituted a restriction on freedom of establishment, (ii) whether the application of the special tax represented to illegal State aid and (iii) whether the special tax is a turnover tax and, if so, whether it is compatible with Article 401 of Council Directive 2006/112/EC of 28 November 2006 (the VAT Directive).

CJEU decision

Similar to its decision on the Hungarian special tax on store retail trade case (C-323/18), the CJEU stated that the fact that companies owned predominantly by foreign shareholders are taxed more heavily is not sufficient to demonstrate that discrimination exists, as the higher rate of tax suffered is due to the fact that these companies are generating the most significant turnover in the market.

The Court made similar comments to those described above with respect to case C-323/18 and ruled that applicant companies cannot rely, before the national courts, on a possible EU State aid illegality in order to avoid payment of the disputed taxes.

EU Tax Centre comment

In her opinion in case C-75/18, Advocate General Kokott, had commented on the character of the Hungarian special tax and had qualified the disputed tax as a direct tax on turnover. The qualification was seen as relevant for the discussion around whether the Digital Services Tax proposed by the European Commission – and certain countries on a unilateral basis - would be deemed a direct or indirect tax (relevant for e.g. double tax treaty relief purposes). However, when addressing the question on whether the disputed tax should be characterized as a turnover tax within the meaning of Article 401 of the VAT Directive, the CJEU limited its comments to the essential characteristics of VAT. The Court found the Hungarian tax not to have all the characteristics of a VAT, but did not comment further on its character as a direct or indirect tax.

Should you have any queries, please do not hesitate to contact KPMG's EU Tax Centre, or, as appropriate, your local KPMG tax advisor.

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