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The Bridge.

Dear Readers,

There have always been and will always be disagreements between taxpayers and the tax authority. As tax consultants we often see cases where the tax inspectors look for typical errors during a tax inspection, ones with the "potential for penalties".

One of their best hunting grounds is undoubtedly **value added tax**, and specifically, **reverse charge and direct taxation** issues. If a taxpayer applied a reverse charge instead of direct taxation, and issued an invoice accordingly, the tax authority may establish a tax shortfall and levy a maximum 50 percent penalty. At the party receiving the invoice we can encounter the opposite.

In our opinion, the [judgement of the Court of Justice of the European Union dated 26 April 2017](#) represents a milestone in several respects. In our article on this topic on page 3, we highlight the points of the lengthy judgement which we believe are useful for taxpayers.

Tamás Gyányi
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VAT fixed establishments

When reviewing VAT fixed establishments the main factor is checking the definition, but this will not make it absolutely clear what duration results in a VAT fixed establishment. » [page 1](#)

Unlawful NAV tax penalty

The Hungarian tax authority cannot ignore the judgement of the Court of Justice of the European Union, and this must be reflected in the NAV's tax penalty procedures. » [page 3](#)

VAT fixed establishments - definition issues**VAT fixed establishment - Hungarian rules**

- lengthy period
- geographically fixed
- conditions for independent activity are in place
- economic activity
- conditions independent of registered office

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Those dealing with value added tax know very well how important the definition for permanent establishments or VAT fixed establishments is in the VAT treatment of international transactions. It can impact on the VAT rate of services provided, but in the case of VAT reclaims abroad, attention should also be paid to whether the company created an establishment in the

given country. If a foreign company creates an establishment in Hungary, then VAT registration along with the extra administrative workload cannot be avoided. We will deal with these issues in our next article, but until then, let's see what the greatest challenge is with regard to this definition.

VAT fixed establishments - Hungarian definition

Any geographically fixed place established or intended to be used for an economic activity **over a lengthy period** at a fixed location other than the registered office, where the **other conditions necessary for conducting the economic activity independently from the registered office are in place**, including the taxpayer's commercial representation in specific cases, shall qualify as a fixed establishment as per the effective Hungarian VAT Act.

It is worth checking out how different the approach of the old VAT Act before 2008 was in respect to the definition of a fixed establishment:

Separate production or business facility with which the taxpayer conducts revenue-generating activity at a fixed location for a **lengthy period**, particularly:

- the place of management;
- a branch;
- a factory site;

- a workshop or warehouse;
- a mine, quarry, oil field or any other site used for the exploitation of natural resources;
- a place of construction, implementation, repair or supervisory activity.

Fortunately we were able to forget this definition after 2008 and the aforementioned definition now in force does not include any exhaustive lists in respect of a fixed establishment.

The biggest problem with the definition of VAT fixed establishments is perhaps that it was not precisely defined **what period qualifies as a "lengthy" period**. This is very important since it can define whether a foreign company has to [register in Hungary for VAT purposes](#) or not. Let's see what the EU regulation requires: is the definition any clearer?

VAT fixed establishments according to the EU's implementing regulation

Based on Council Implementing Regulation (EU) No 282/2011, primarily examining the party using the service, a "fixed establishment" shall be any establishment **characterised by a sufficient degree of permanence and a suitable structure in terms of human and technical resources to enable it to receive and use the services supplied to it for its own needs**. From the perspective of the party providing the service, a "fixed establishment" shall be any establishment characterised by a sufficient degree of permanence and a suitable structure in terms of human and technical resources to enable the provision of services.

There is nothing about periods here, indeed, there are differences between the Hungarian and the EU regulation. Please note that the definition of permanent establishment in the [double taxation treaties](#) is not the same as that of VAT fixed establishments. While the Model Tax Convention uses examples to help identify permanent establishments in the case of direct taxes, it is not easy to define how a fixed establishment is created from the perspective of indirect taxes. Sometimes EU case law provides the only point of reference (e.g. the ARO Lease, Berkholz or Welmory cases).

What is the practice of the Hungarian tax authority (NAV)?

Having reviewed the practice of the National Tax and Customs Authority (NAV) applying Hungarian law, it is clear that inspectors always decide whether Hungarian VAT fixed establishments are created by assessing the given transaction and all of its circumstances. The inspectors may examine the duration of the contractual and the actual activity performed in Hungary, alongside other conditions included in the definition. We can say that **a period in excess of 12 months certainly creates a VAT fixed establishment and thus a registration obligation**, while providing a service for a shorter period of 3 months or no more than 6 months would probably not create a VAT fixed establishment.

Naturally, there must be an in-depth review of the given transaction and the type of the transaction since the **wrong assessment of an establishment could result in the NAV determining a tax shortfall along with a maximum tax penalty of 50% and default interest**.



"The most significant innovations are the so-called country-by-country reporting and automation."

András Szadai, WTS Klient Hungary senior manager

Source: inforadio.hu



Have you heard?



András Szadai, senior manager at WTS Klient, spoke about transfer pricing rules and their expected changes on InfoRadio. "This is essentially all about collecting information; the national tax authorities want to receive information that is as detailed as possible, from as many places as possible, at the same time, and ideally, automatically" – underlined the expert.

[Listen to the conversation at this link!](#)

Please note that the conversation is available only in Hungarian.

Judgement of the Court of Justice of the European Union – unlawful NAV tax penalty

According to the judgement, the following must be taken into account:

- the seller was under liquidation
- the VAT had previously been paid
- there was no suspicion of tax fraud, the taxpayer acted in good faith
- the central budget did not suffer any loss

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Not so long ago we [reported](#) on a Hungarian case at the Court of Justice of the European Union based on the Advocate General's opinion. The judgement was passed on 26 April, and we can easily say that it surpasses all expectations. Taxpayers can rejoice because the penalty-levying practice of the Hungarian tax authority (NAV) has once more been rebuked.

Why is the judgement regarding the NAV tax penalty case good for taxpayers?

In this case, the NAV challenged the VAT deducted for the purchase of a mobile hangar, capitalising on the difficulties experienced in qualifying transactions between direct taxation and reverse charges. Additionally, it imposed a tax penalty totalling 50% of the VAT amount. To add insult to injury, the supplier was under liquidation, so it would not have been able to repay the tax to the taxpayer.

The judgement rectified the two major problems since it did not consider the maximum 50% penalty justified; what is more, in respect of the tax repayment it also added that the taxpayer should be able to reclaim the tax directly from the NAV. We believe this latter aspect represents a huge blow to the tax authority, and gives hope to taxpayers who unwillingly find themselves in unpleasant situations.

We rarely quote something to the letter, but in this case, it is worth getting to know the main points of the judgement (without the legal slang).

"The principle of proportionality must be interpreted to the effect that **it precludes national tax authorities, in a situation such as that in the main proceedings, from imposing on a taxable person, who purchased an item of property the transfer of which comes under the reverse charge regime, a tax penalty of 50% of the amount of value added tax which he is required to pay to the tax authority, where those authorities suffered no loss of tax revenue and there is no evidence of tax evasion, this being a matter for the referring court to determine.**"

... it cannot be contested that "in a situation such as that in the main proceedings, the relevant provisions may not preclude the purchaser of an item of property from being deprived of the right to deduct the VAT which he paid to the seller when that tax was not due, on the basis of an invoice drawn up in accordance with the rules of the ordinary VAT regime, where the relevant transaction came under the reverse charge mechanism, and the seller paid that tax to the Treasury. However, **to the extent that reimbursement of the unduly invoiced value added tax by the seller to the purchaser becomes impossible or excessively difficult, in particular in the case of the insolvency of the seller, those principles require that the purchaser be able to address his application for reimbursement to the tax authority directly.**"

According to the reasoning of the judgement, **Member States must provide for the instruments and the detailed procedural rules necessary to enable the purchaser to recover the unduly invoiced tax** in order to respect the principle of effectiveness.

Consequently, the following facts cannot be ignored:

- the seller was under liquidation, which may imply that reimbursement of the unduly invoiced value added tax by the seller to the purchaser was impossible or excessively difficult;
- the VAT was previously paid to the seller (it could also be checked whether the seller actually paid the amount to the central budget or not, although this does not matter from the perspective of the taxpayer);
- the suspicion of tax fraud did not arise, the taxpayer acted in good faith;
- the central budget did not suffer any loss.

What will the consequences of the judgement be?

In terms of the **NAV tax penalty**, the tax authority itself could have decreased (or completely waived) the penalty during the proceedings since this is permitted by the Act on Rules of Taxation. Our practical experience shows that in similar cases the NAV usually does not start out with a 50% penalty, yet based on the VAT content of any given transaction, a 5 or 10% penalty can also be significant. We trust that tax inspectors and their supervisors also read the court judgements, and in similar cases they will not take the maximum penalty as the default situation.

The law does not allow direct reimbursement from the tax authority, though in specific cases, Hungarian courts do take the final conclusions of the judgements by the Court of Justice of the European Union on tax issues into consideration. Based on this specific case we think it is justified to incorporate a provision into Hungarian legislation where taxpayers in similar situations can turn to the Hungarian tax authority with a direct reimbursement request.

In light of the judgement it is even worth reviewing previous tax inspections where, in similar situations (insolvent seller company), VAT previously paid could not be reclaimed.

Services of the WTS Klient Hungary:

- » Tax consulting
- » Financial advisory
- » Legal consulting
- » Accounting
- » Payroll

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Should you have any questions regarding the above or any other professional issues, please do not hesitate to get in touch with your WTS advisor or use any of the contact details below.

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