



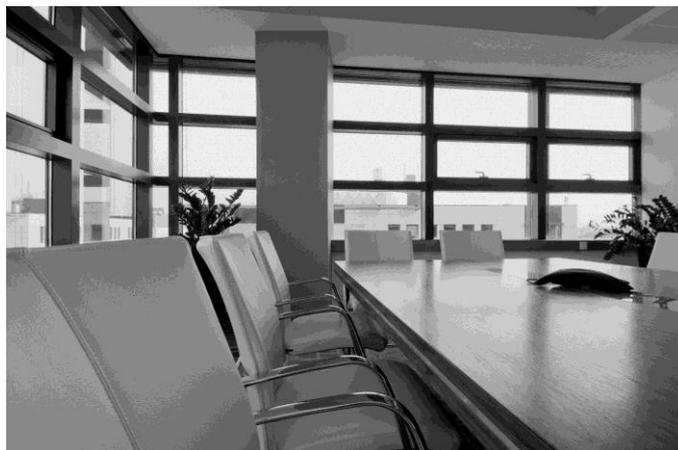
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Bringing VAT “back from the dead”

Companies are faced with countless situations where, for reasons beyond their control, they are unable to collect the money owed to them, including its VAT part. In such cases the tax authority often refuses to allow the reclaim of the lost VAT even where this would not incur a loss for the budget. Based on recent judgements by the European Court of Justice (ECJ), however, the VAT should be recoverable in many cases of this kind.

Based on the tax-authority practice applied consistently for many years now, Hungarian taxpayers are unable to reclaim their paid-in VAT in many situations where granting a rebate of the tax would not result in a loss for the national budget. In such cases, the state is “unlawfully enriched” due to an excessively strict interpretation of the VAT rules. This lends particular importance to a number of ECJ decisions pronounced in the past few months, which have departed from this strict approach and awarded VAT rebates even in cases where this would have seemed unimaginable in the past.



Mis-charged VAT

One typical instance is when the seller has mistakenly charged VAT when there was no need to do so. This might occur, for example, when the parties applied standard VAT payment instead of the reverse charge mechanism. In this case, the buyer has unnecessarily transferred VAT to the seller, and the seller in turn has needlessly paid the VAT to the tax authority.

Under EU practice, if an invoice has been erroneously issued, the parties have to correct the invoicing in line with the applicable legal requirements. In the case described above, therefore, the seller would have to cancel the VAT invoice and issue a new one with reverse charge VAT. Based on this, the seller can reclaim the unnecessarily paid VAT, and the buyer – ultimately in a civil lawsuit if necessary – can demand that the seller repays the VAT that it has paid, but did not actually owe.

It may be the case, however, that the buyer can no longer recover the needlessly paid VAT from the seller, especially if the seller has been dissolved or been wound up in the meantime. And sometimes the buyer is unable to recover the VAT from the seller even after winning a civil lawsuit.

In such circumstances, under the present Hungarian practice, the buyer is unable to reclaim the VAT directly from the tax authority. Based on the ECJ's decision in the Farkas case, however, this should not be so. Here, the ECJ found that the buyer could reclaim the VAT provided that no tax evasion had taken place between the parties, and the budget had sustained no losses.

Advance payments down the drain

Another possibility is that a customer pays an advance but the seller does a runner, not paying it back but also failing to deliver the ordered product or service. In these cases, as no delivery has been made, the customer usually can't deduct the VAT part of the advance payment. In this way, not only the advance payment is lost, but also the VAT paid on it.

In two similar cases, however, the ECJ has recognised the customer's right of tax deduction, arguing that the customer paid the advance in good faith and had every reason to believe that the seller would keep their side of the bargain. Indeed, according to the ECJ, VAT neutrality can only be ensured as long as the buyer's right of tax deduction is not denied, even retrospectively. In this way, from a VAT perspective everyone has recouped their losses, and only the net advance has gone "down the drain".

Clearly then, in this case too, the ECJ took into account the fact that the budget had sustained no loss, and also gave consideration to the economic realities faced by companies in the course of their operations.

VAT on uncollectable claims

In many cases, VAT can be lost by a service provider when a receivable proves to be uncollectable. The Hungarian tax authority's position on this is clear: the VAT paid on uncollectable receivables cannot be reclaimed. The reasoning is that the VATable service has been performed, regardless of whether or not the customer has paid the consideration for it.

Recent ECJ decisions, however, have been more permissive in this regard too, stating that it goes against the EU VAT Directive for the tax authority not to refund the VAT paid on receivables that appear to be permanently uncollectable. The only condition for claiming a rebate of the VAT is that the seller should be able to prove that its receivable is uncollectable, or at least demonstrate that attempts at collection will probably prove to be unsuccessful.

Where is all this leading?

Obviously the European Court is moving steadily away from its previously rigid approach to VAT issues, which – often running contrary to budgetary logic and fairness – in some cases also hit bona fide businesses with genuine additional VAT burdens. Although the Hungarian tax authority will resist taxpayers' requests based on these rulings for a while, sooner or later the ECJ's judgements will also have an impact on the Hungarian VAT system. Until that happens, however, businesses who want to claw back their VAT will need to prepare for some tough battles.