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COMMENT ON *HERVIS SPORT- ÉS DIVATKERESKEDELMI KFT. V. NEMZETI ADÓ- ÉS VÁMHIVATAL KÖZÉP-DUNÁNTÚLI REGIONÁLIS ADÓ FŐIGAZGATÓSÁGA* (CASE C-385/12)

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The Court of Justice of the European Union (CJEU), in its judgment of 5.2.2014 in case C-385/12, handed down judgment in a preliminary ruling requested by a Hungarian court. The request concerned the interpretation of Articles 18, 26, 49, 54 to 56, 63, 65 and 110 TFEU, so the issue referred by the national court related to Treaty provisions concerning the freedom of establishment, the freedom to provide services and the free movement of capital. However, the CJEU limited its answer to an interpretation of Articles 49 and 54 TFEU, while the opinion of Advocate General (AG) Kokott had suggested a different solution based on an analysis of turnover taxes under the Value Added Tax Directive (VAT directive).[1]

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[1] Council Directive 2006/112/EC of 28.11.2006 on the common system of value added tax, O.J. 11.12.2006 L 347, p. 1.

1. The judgment of the Court of Justice

In the main proceedings, a Hungarian company (Hervis Sport- és Divatkereskedelmi Kft: Hervis) questioned the compatibility of its obligation to pay a special tax on the turnover of certain sectors of the store's retail trade. The tax was introduced in Hungary for the years 2010-12 by Law No XCIV of 2010[2] and established a steeply progressive scale of a special tax on the overall turnover of linked undertakings. The concept of linked undertakings was defined in Article 4 of Law No LXXXI of 1996.[3] Hervis is a legal person and a subsidiary of the Austrian SPAR chain, thus falling within the category of linked undertakings. Hervis was obliged to pay a share in proportion to its turnover on the basis of the overall turnover of the SPAR chain achieved in Hungary. As a result of the steeply progressive scale of the special tax to the overall turnover of the whole group to which Hervis belongs, the tax rate applied to Hervis was considerably higher than that which would apply solely on the basis of the taxable amount of the turnover of its own stores. Hervis claimed that the tax was discriminatory and contrary to EU law. Therefore the Székesfehérvári Törvényszék (the national Hungarian court) decided to stay proceedings and to refer the question to the CJEU.

The CJEU examined whether either direct or indirect discrimination could be established concerning the interpretation of Articles 49 TFEU and 54 TFEU by referring to its settled case law.[4] It stated that the legislation in question had not imposed any criterion of direct differentiation

[2] Law No XCIV of 2010 on a special tax on certain sectors of activity (az egyes ágazatokat terhelő különadóról szóló 2010. évi XCIV. törvény) introduced a new tax, called a special tax, on three main sectors of the Hungarian economy – store retail trade activities, telecommunications activities and all commercial energy supply activities – which those affected have to pay for three consecutive years on the basis of their turnover before tax.

[3] Law No LXXXI of 1996 on tax on companies and dividends (a társasági adóról szóló 1996. évi LXXXI. törvény).

[4] Schumacker C-279/93, Judgment of 14.2.1995, E.C.R. 2005, p. I-225, para. 26; Talotta C-383/05, Judgment of 22.3.2007, E.C.R. 2007, p. I-2555, para. 17, and Gielen C-440/08, Judgment of 18.3.2010, E.C.R. 2010, p. I-2323, para. 37.

between undertakings based on the location of their registered offices [para. 31 of the judgment]. However, it differentiated between companies which are linked to other companies within a group and those which are not. The CJEU established that, in fact, the national legislation may disadvantage the first type of companies if it imposes the highest band of the special tax to "linked" companies because of the method of calculation of their taxable turnover. Although the calculation of turnover is based on objective criteria, following the application of the highly progressive rate of the tax the combination of these two characteristics may lead to indirect discrimination [paras 32–38].

The CJEU left it for the national court to establish whether the taxable persons belonging to a group of companies are in the majority of cases "linked" to companies which have their registered offices in other Member States (MS) or not. If so, according to the CJEU, indirect discrimination may be identified on the basis of the registered office of companies, which is incompatible with the freedom of establishment [paras 39–40].

Indirect discrimination is however permissible by EU law if it can be justified by overriding reasons in the general interest. According to the CJEU's settled case law, "protection of the economy"[5] or the "restoration of budgetary balance by increasing fiscal receipts"[6] do not constitute acceptable reasons [para. 44]. Therefore the Hungarian Government did not invoke any justification.[7]

The CJEU therefore held that Articles 49 TFEU and 54 TFEU must be interpreted as precluding such national legislation which establishes a tax on turnover, since it fails to meet the conditions mentioned above.

[5] Verkooijen C-35/98, Judgment of 6.6.2000, E.C.R. 2000, p. I-4071, paras 47-48.

[6] X and Y C-436/00, Judgment of 21.11.2002, E.C.R. 2002, p. I-10829, para. 50.

[7] As stated by some academics, "aims of a purely economic nature cannot constitute overriding reasons in the general interest" see in Koen Lenaerts, Piet Van Nuffel, *European Union Law*, Sweet & Maxwell, Third Edition 2011, p. 282. Economic aims are held to be incapable of justifying restrictions or disadvantages of the national legislation (see SETTG C-398/95, Judgment of 5.6.1997, E.C.R. 1997, p. I-3091, para. 23). Furthermore, a MS cannot validly rely in order to justify the indirectly distinguishing provisions of the national legislation on the need to ensure tax revenue (see Gambelli and Others C-243/01, Judgment of 6.11.2003, E.C.R. 2003, p. I-13031, para. 61 and also Commission v Italy C-388/01, Judgment of 16.1.2003, E.C.R. 2003 p. I-721, para. 22).

2. The opinion of the Advocate General

In her opinion, AG Kokott adopted a different approach. She examined in detail, firstly whether the Hungarian special tax was compatible with Articles 49 and 54 TFEU and then, secondly, if it was contrary to the VAT directive.

First, concerning Article 49 TFEU, read in conjunction with Article 54 TFEU, she established that EU law did not preclude the levying of the Hungarian special tax. The reasoning was based on an analysis of the case law of the CJEU on discrimination. She examined *inter alia* whether indirect or covert discrimination existed and noted that the CJEU's existing case law does not precise the conditions for covert discrimination concerning the freedom of establishment [paras 37-39]. Thus far, the CJEU has referred to both a "correspondence in the majority of cases"[8] and has also accepted that covert discrimination exists when a "mere preponderance of non-residents [were] affected",[9] or even where there existed a "mere risk of disadvantage".[10] AG Kokott, in criticizing the existing case law, suggested that the CJEU should apply stricter criteria to the evidence of covert discrimination since, in her opinion, "covert discrimination is not intended to extend the scope of the discrimination, but only to include cases which do not constitute discrimination from a purely formal perspective, but have the same effect".[11]

Therefore, she examined the criterion of the turnover level of taxable persons from the point of view of possible unequal treatment and asked

[8] Stanton and L'Etoile 143/87, Judgment of 7.7.1988, E.C.R. 1988, p. 3877, para. 9; Commerzbank C-330/91, Judgment of 13.7.1993, E.C.R. 1993, p. I-4017, para. 15; Baxter and Others C-254/97, Judgment of 8.7.1999 E.C.R. 1999, p. I-4809, paras 10 and 13, and Talotta C-383/05, para. 32; see also Bergandi 252/86, Judgment of 3.3.1988, E.C.R. 1988, p. 1343, para. 28, and Schmelz C-97/09, Judgment of 26.10.2010, E.C.R. 2010, p. I-10465, para. 48.

[9] Blanco Pérez and Chao Gómez C-571/07, Judgment of 1.6.2010, E.C.R. 2010, p. I-4629, para. 119.

[10] Talotta C-383/05 [2007] E.C.R. I-2555, para. 32, and Blanco Pérez and Chao Gómez C-571/07, para. 14.

[11] Para 40 of the opinion of AG Kokott.

whether the situation of different groups of taxable persons is objectively comparable. According to AG Kokott, firstly, the rate of the special tax with reference to the level of turnover is not evidently discriminatory; secondly, the level of turnover is not a distinguishing criterion between resident and non-resident companies (i.e. higher turnover in the case of foreign companies as opposed to lower turnover for domestic companies); thirdly, the situation of taxable persons affiliated to a franchise system is not comparable to the situation of taxable persons integrated within a group and fourthly, the distinguishing criterion of the stage of the distribution chain for turnover purposes does not lead to conclusion that indirect discrimination exists. Therefore, she precluded the possibility that either direct or indirect discrimination was present. Consequently, she concluded that the Hungarian special tax contained no discriminatory provisions (either direct or indirect) concerning the freedom of establishment of companies and therefore that the freedom of establishment of Hervis and its parent company had not been unlawfully restricted. Accordingly, she suggested that the provisions establishing the special tax were not contrary to EU law.

Second, AG Kokott's opinion took the view that the tax may be contrary to the VAT directive since it threatened the functioning of the common VAT system.[12] She considered it necessary that the referring national court examine whether the special tax is compatible with Article 401 of the VAT directive, which preclude MS from levying taxes which can be characterized as turnover taxes. It is settled case law that a tax may be characterized as a turnover tax if it jeopardizes the functioning of the common system of value added tax and distorts competition, whether at a national or EU level, and fulfils the following four conditions: the deduction of an input tax (1) and the charging at each stage (2) [which criteria do not constitute the essential characteristics of a turnover tax in the view of the AG[13]], as well as an assessment on the basis of the price (3) and the general levying (4), [which are both essential features

[12] Source: Hungary: retail tax may infringe EU law by Eszter Kálmán and Tamas Feher (September 10 2013) available at: http://www.lexology.com/library/detail.aspx?g=e6aa60c7-f1a4-471c-bf87-cf65ff253418 [consulted on 10.4.2014].

[13] AG Kokott criticised the existing case law and concurred with AG Mischo and Stix-Haackl on that point [points 104 and 106 of the opinion of AG Kokott].

of a turnover tax within the meaning of Article 401 of the VAT directive in the view of the AG]. In her opinion, the Hungarian special tax would satisfy the characteristic of assessment on the basis of the price charged.

However, in the present case, an interpretation of Article 401 of the VAT directive was not requested by the referring national court and therefore the available information in the reference was insufficient to establish whether or not the special tax constituted a general turnover tax.

Therefore AG Kokott suggested that the CJEU interpret the question in such a manner that the national court should further analyse the characteristics of the special tax in order to establish whether or not it was compatible with EU law.

3. Comments

Whilst the recommendations of the AG and the eventual solution adopted by the CJEU are undeniably different, it is common that both suggested that it is the role of the national court to analyze the specificities in question and to decide the case.

According to the instructions in the judgment of the CJEU, in order to establish a breach of EU law concerning the freedom of establishment and the existence of indirect discrimination, it should be proved that in most cases similar to the situation of Hervis, the disadvantage caused by the progressive rate of the tax is a burden which falls on a foreign company,[14] which would require an examination of Hungarian market structure.

[14] The instructions of the CJEU to the national court at this point can be criticized. It can be questioned why the indirect discrimination established only in one separated case, as in the situation of Hervis, is in itself insufficient to establish a breach of EU law. If the disadvantage in an individual's case can be shown, then regardless of the scale of the equally disadvantages situations in the MS, this should suffice to establish a breach of EU law. In that case, the national court could further examine whether the combination of characteristics of the special tax lead to indirect discrimination within the scope of the proceedings concerning Hervis instead of analyzing the market structure according the instruction of the CJEU [para. 39 of the judgment]. That comment however has no basis in the view of either the judgment of the CJEU or in the opinion of the AG. AG Kokott underlined that "The correlation between the distinguishing criterion and the

Taking into account the structure of store retail trade in Hungary,[15] in the majority of cases "linked" taxable persons within the meaning of the law governing the special tax in question are companies which have their registered offices in other MS (Décathlon, Intersport, Spar, Lidl, Auchan, Metro and Tesco chains are represented in Hungary and their Hungarian subsidiaries are mostly affected by these tax regulations).[16] Therefore, the condition of the CJEU would probably be fulfilled.[17]

An analysis of the market structure by the national court, even assuming that such data is available for the relevant tax years, would probably require in-depth economic expertise and various calculations. This may prolong the procedure before the national courts, which is unfavorable for those taxpayers awaiting the decision but definitely in the interest of the government.

Taking into account the solution suggested by the AG, an analysis of the characteristics of the special tax in light of the VAT directive would require detailed knowledge of the tax system, which also brings the risk of the prolonging the national procedure. Moreover, the national court should make an objective evaluation of the provisions in question concerning the compatibility of the special tax with EU law, but it cannot leave aside the legal and factual background of the Hungarian economy and governmental fiscal policy and its budgetary plans. Following the opinion of the AG, the government already argued that the tax cannot be characterized as a turnover tax within the meaning of the VAT directive and that it is therefore compatible with EU law. However, it will be the task of the national court to evaluate whether such arguments shall be taken into account.

place in which the company has its seat must … be identifiable in the vast majority of cases. A mere preponderance of non-residents being affected is not therefore sufficient." [para. 41 of the opinion of the AG].

[15] Source: Hervis – Adó Online available at: www.ado.hu/search/Hervis [consulted on 10.04.2014].

[16] RSM DTM Hungary Blog, Hegedüs Sándor, 12.11.2012; available at: http://blog.rsmdtm.hu/2012/11/tul-szepnek-tunt-adovaltozasok-a-tancparketten/ [consulted on 10.4.2014].

[17] RSM DTM Hungary Blog, The HERVIS affair not yet over; available at: http://blog.rsmdtm.com/2014/02/the-hervis-affair-not-over-yet/ [consulted on 10.4.2014].

Finally, one should agree that although the CJEU's approach differed from that of AG, the judgment itself does not preclude the possibility that the final result of the case will be the same as was suggested by the AG, since the same national court or the eventual appeal court may request another preliminary ruling concerning the VAT directive.

4. Conclusions

The reason behind the introduction of the special tax in question was that the financial and economic crisis in Hungary encouraged the government to seek alternative sources of revenue by introducing new kinds of tax alongside traditional ones. It is clear that a reduction of the government deficit is possible through decisions that bring new revenue. In 2010 there was a breakthrough in the tax system as a result of Hungary's Structural Reform Programme 2011–2014. The Program aimed at "consolidating the Hungarian public sector by means of structural reforms, strengthening economic growth, encouraging the increase of employment and enhancing the competitiveness of Hungary's economy".[18] It introduced extraordinary measures such as a tax on banks, crisis taxes and the reform of private pension funds payments in order to meet fiscal targets. This policy of the Hungarian government has been largely criticized; however, after a few years it seems to have brought positive results to lead the country out of the crisis.

The tax in the present case was introduced in order to cope with high public financial needs. It was, however, introduced only for a limited period of time. It is easy to consider that the government took into account that the special tax would be profitable even if it could only be applied for a limited period of time. The tax rules were changed shortly after the reference of the national court for a preliminary ruling. This hypothesis seems to be confirmed by the fact that the government did not offer any justification during the proceedings before the CJEU.

[18] Source: Hungary's Structural Reform Programme 2011–2014, Ministry for National Economy, Budapest, March 2011; available at: http://www.kormany.hu/download/b/23/20000/Hungary's%20Structural%20Reform.pdf [consulted on 10.4.2014].

The CJEU's judgment demonstrated absolute trust to the national court to decide whether or not the provisions of the special tax were compatible with EU law.

However, even in the event that the national court establishes that a breach of EU law occurred, it is not obvious that Hervis and other companies in a similar situation will be able to apply for reimbursement of the unlawful part of the tax. The special tax on the store retail trade had effect from 2010 until the end of 2012.[19] Therefore the judgment should be applied with retroactive effect. Moreover, it is the task of the national court to decide which of the provisions of the special tax were incompatible with EU law, which affects largely the question of eventual reimbursement. In the event of an eventual reimbursement, the time-limit for application is also strict – 180 days from the date of notification of the judgment of the national court – which restricts the probability that the scale of reimbursements of the illegal amounts of this tax would affect the national budget.[20] The question is rather whether other taxes similar to the special tax on store retail trade, especially the insurance and local tax introduced by the Hungarian legislation package for the tax year 2013 to replace the tax in question, and which have a similar progressive rate, are also compatible with EU law.

Therefore, one should conclude that the relevance of the Hervis case goes beyond that what was said by the CJEU in its judgment. Having noticed the legal provisions introducing the special tax, the Commission brought a separate action against Hungary for failure to fulfil its obligations, (Case C-462/12)[21] concerning the special tax of the electronic communications services in October 2012, however in November 2013 it withdrew its application[22]. Furthermore, following the expiry of the

[19] Temporary extra taxes on retail trade and telecommunication sectors were abolished by the end of 2012. Source: http://www.kormany.hu/en/ministry-for-national-economy/news/temporary-extra-taxes-on-retail-trade-and-telecommunication-sectors-to-be-abolished [consulted on 10.4.2014].

[20] The Hungarian Government has probably already taken these factors into account in deciding not to submit any justification for its breach of EU law. It is quite probable that from a budgetary perspective that it remained worthwhile introducing the special tax even in the event of several eventual requests for reimbursement.

[21] Action brought on 12.10.2012: European Commission v Hungary (Case C-462/12).

[22] Order of 22.11.2013, Commission v Hungary C-462/12.

period for which the special tax existed (it was liable to be paid only for three consecutive years from 2010 until the end of 2012) the tax concerning store retail trade was replaced by an insurance and local tax. In spite of this change, the method of calculating the tax remained similar to the tax discussed in the present case. Therefore in time it may await similar criticism. Moreover, based on similar arguments, the European Commission also questioned the system of issuing meal and holiday vouchers and instructed Hungary to ensure provision of the freedom of establishment and the freedom of services.[23]

Finally, bearing in mind the heavy workload of the Hungarian judiciary, the reopening of the Hervis case by the referring court may take some time and it is also possible that the judgment will be appealed before the higher courts. If so, the appeal court may again request a preliminary ruling (as was suggested by AG Kokott on the issues concerning the VAT). Therefore, one should wait for further developments at a European and national level in order to draw any final conclusions regarding this case.

[23] Source: EU warning in tax matters: is trouble ahead with local business tax and insurance tax also? Available at: http://blog.rsmdtm.com/2012/11/eu-warning-in-tax-matters-is-trouble-ahead-with-local-business-tax-and-insurance-tax-also/ [consulted on 10.4.2014].