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CJEU: 20 percent VAT sanction is incompatible with EU law

On 15 April 2021, the Court of Justice of the European Union issued a decision in the case C-935/19 on EU law compatibility of Polish regulations providing for the application of penalties in the form of an additional VAT liability (VAT sanction) by tax authorities in the case of finding a difference between the amount of tax due, tax refund or an excess of input tax over the due tax and the amount declared by the taxpayer.

According to CJEU, imposing a 20 percent penalty on a taxpayer (purchaser of real estate), who erroneously recognized the transaction as not covered by the exemption, while it should have been entirely exempt from tax, and, consequently, deducted the input tax, is consistent with the provisions of the VAT Directive and the resulting principle of proportionality.

The key conclusions of the ruling can be found below.

Background

The case at hand concerned a Polish company, which purchased a developed property occupied for more than two years. The notarial deed included a declaration that the price of the buildings stated was the gross amount (including VAT). The purchase was additionally documented by an invoice issued by the seller, which showed, inter alia, the amount of VAT due.

The purchasing company paid the tax, qualifying it as input tax due. Next, it included this amount as deductible input tax in the submitted return. As a result,

an excess of input tax over output tax to be refunded to the company's bank account was shown.

Yet, following an audit, the tax authority found that under the existing provisions, the transaction concerning the supply of the property should have been entirely exempt from tax and that the parties to the transaction had failed to submit a declaration that they had opted to waive the exemption. Consequently, the authority established that the company was not entitled to deduct the input tax resulting from the tax-exempt supply of property.

As a result, the company submitted a correction to its tax return which took into account all the irregularities found during the audit. Despite the submission of the correction, the tax authority issued a decision which imposed on the company an additional tax liability corresponding to 20 percent of the amount of the overstated VAT refund.

Request for a preliminary ruling

As a result of the appeal lodged, and a subsequent complaint filed, the case was brought before the Regional Administrative Court in Wrocław, which, by way of decision of 3 October 2021, case file I SA/Wr 448/19, decided to ask CJEU to give a preliminary ruling concerning the compatibility with European Union law of the imposition of an additional VAT liability.

The Polish court considered necessary to determine whether the application of penalties in the

form of an additional tax liability where no tax revenue was lost, as a result of an erroneous understanding of applicable laws, is compatible with the principle of proportionality and VAT neutrality and whether the imposition of such additional liabilities actually serves to prevent tax fraud or is merely an additional fiscal measure.

CJEU's ruling

In its ruling, CJEU admitted that under the VAT Directive, Member States may adopt provisions necessary to attain the objectives of ensuring the correct levying and collection of the tax and preventing fraud. Moreover, they remain empowered to choose the sanctions which seem to them to be appropriate, applicable where conditions laid down by arrangements under that legislation are not complied with.

The Court noted, however, that such penalties must not go beyond what is necessary to attain the objectives of ensuring the correct levying and collection of the tax and preventing fraud. Thus, in order to assess whether a penalty is consistent with the principle of proportionality, account must be taken, inter alia, of the nature and the degree of seriousness of the infringement which the penalty seeks to sanction, and of the means of establishing the amount of the penalty.

Furthermore, CJEU pointed out that the penalties in question were primarily preventive in nature, as their aim was to "convince taxable persons that it is in their interest to complete their tax returns in an accurate and diligent manner"

and, where an error is found in a settlement - to make all the necessary corrections, as to achieve the objective of ensuring the correct collection of VAT.

Yet, under the regulations in force, where the penalty is set at 20 percent of the overstated VAT difference to be refunded, it cannot be reduced according to the specific circumstances of a given case (except in cases where the irregularity is due to minor errors).

In the form in which it has been introduced, the provision does not account in any way for the taxable person's intention, thus making no distinction between whether the understatement of the tax was due to error, with no indications

of a fraud, and did not result in unlawful reduction of tax liability, and situations where there are no such special circumstances.

Therefore, according to CJEU, the automatic imposition by operation of law of an additional tax liability deprives the authorities of the possibility to adjust the penalty to particular circumstances and to ensure that it does not go beyond what is necessary to attain the objectives of ensuring the correct collection of the tax and preventing tax fraud.

Consequently, CJEU ruled that EU VAT regulations must be interpreted as precluding national rules which impose on the taxpayer who incorrectly classified a VAT-exempt

transaction as a transaction subject to that tax, a penalty of 20 percent of the amount of overstated VAT reimbursement unduly claimed, where there are no indications of fraud and depletion of revenues to the state treasury.

The ruling opens the pathway for other taxpayers to recover VAT penalties imposed by tax authorities. Each claim, however, should be thoroughly analysed on a case-by-case basis.

If you would like to learn more about the issues discussed, please do not hesitate to contact us.

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