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Irrecovable Debts and Limitation Periods for VAT Purposes: The *ENERGOTT* Case

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The authors present the current *ENERGOTT* case of the Court of Justice of the European Union (C-643/20), where the three principles of VAT are challenged by a request for a preliminary ruling: equivalence, effectiveness, and neutrality.

The subject matter of the request is repayment of VAT relating to debts which have become definitively irrecoverable. The Court was asked to determine the moment which may be stipulated by Member States as the starting point of the limitation period for the refund of VAT applicable to such debts, and to determine whether the set of conditions laid down by a Member State, in respect of the refund of VAT, are precluded by the European case-law and principles.

This case is important for taxpayers in the European Union because the judgment might give them the right to challenge national legislation in the field of the statute of limitations in certain circumstances.

Keywords: VAT, principle of neutrality, principle of effectiveness, principle of equivalence, statute of limitations, definitevely irrecoverable debts

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Introduction

EU Member States enjoy discretion in laying down procedural rules governing natural and legal persons' claims stemming from the European Union law, but the "procedural autonomy of the Member States" is often interpreted too broadly and imprecisely (C-591/10, Op. AG Trstenjak, para. 23). The national procedural autonomy of EU Member States is restricted by the dual principles of equivalence and effectiveness. According to the Court's case-law, there is no absolute discretion of Member States because Member States have a duty to facilitate in procedural law the enforcement of claims arising out of the EU law (C-591/10, Op. AG Trstenjak, para. 24). As stated in the judgment of the Court in *MyTravel plc v Commissioners of Customs & Excise* (C-291/03):

> In the absence of Community rules on applications for the repayment of taxes, it is for the domestic legal system of each Member State

> to lay down the conditions under which such applications may be made; those conditions must observe the principles of equivalence and effectiveness, that is to say, they must not be less favourable than those relating to similar claims founded on provisions of domestic law or framed so as to render virtually impossible the exercise of rights conferred by the Community legal order.

The principle of neutrality has been explained many times at the European Court in a way that it protects the right of taxpayers to remain as far as possible relieved of the burden of VAT.

For example, in paragraph 33 of the judgment in the case *GST – Sarviz AG Germania* (C-111/14), the Court held that it is an obligation for Member States to provide taxpayers with the possibility of adjusting any tax that has been improperly invoiced if the issuer shows that he acted in good faith. Moreover, if the issuer eliminated in whole the risk of any loss of tax revenue, in accordance with the principle of neutrality of VAT, improperly invoiced VAT may be corrected without any conditions upon the issuer's good faith or the discretion of the tax authority.

VAT is a consumption tax that applies to all activities of taxpayers in every phase of the production and distribution of goods and services. A neutral effect on enterprises is safeguarded by a perfectly established mechanism of payments, whereby VAT collected from customers is deducted from the VAT on purchases (Arbutina & Bogovac, 2014), so the final customers bear the burden of tax, due to the fact that they are not taxpayers, thus they cannot submit tax returns and calculate input VAT as deductible amounts. The complicated technical aspects of its functioning ensure the timely collection of tax for the budget, so States' revenues might be eroded only in the case of tax fraud or any purposely or accidentally avoided tax obligation. In the end, mutual satisfaction is achieved: VAT is neither a cost nor a revenue for enterprises, it is constantly paid to the budget, and final customers bear the burden of VAT but often "under anesthesia", since the tax is included in the total prices of the products or services, and is thus less perceived as a tax paid.

However, there are many cases in practice when VAT ends up as a cost for taxpayers. Some of the cases include reasonable circumstances where enterprises act like final customers: receiving benefits in kind, or exemption of goods and services by shareholders or employees, or having deficits on assets above the prescribed amounts. Still, there are many occasions where taxpayers act like enterprises, but cannot deduct input VAT with regard to goods and services bought for business purposes, or they have to calculate and pay VAT on sold goods and services to the budget, but later changes in business circumstances arise, which means that VAT is never received from their customers.

In all these cases, the highly sophisticated technical system of the VAT chain is broken, and VAT becomes a cost for taxpayers. Consequently, the principle of neutrality is not achieved, and both the profitability and competitiveness of enterprises are diminished.

These costs can be significant, so the negative impact of the violation of the principle of neutrality might be of vital importance for many taxpayers. For example, the standard VAT rate in Croatia is 25%, while the economy, institutional capacity and the capacity of taxpayers are constantly falling behind by comparison with other EU Member States (Bogovac, 2020). This means that one fifth of the final price for the majority of goods and services of Croatian taxpayers is tax that is revenue for the State, not for enterprises. Nevertheless, this amount increases the total amount of the goods and services, and if the amounts of some receivables are considerable for the taxpayer, being at the same time uncollectable and not considered as such from the tax authorities,[1] issues relating to the solvency of the taxpayer are multiplied by VAT.

[1] In accordance with Croatian VAT Act, art. 33, para. 7, the supplier may correct a VAT amount from an invoice because it is not collectible only if the reciever of the invoice is a taxable person and the receiver corrects the deduction of input tax and notifies the supplier thereof in writing.

In addition to these latent costs of VAT, there are also compliance costs borne by taxpayers, which cannot be avoided. The importance of these costs for this topic lies in the fact that every taxpayer has many obligations with regard to the calculation, documentation, reporting, and payment of VAT, being all the time subject to audit by tax and customs authorities, while tax legislation is changing on a regular basis. Taxpayers are acting like agents of the State, who calculate, collect, and pay VAT, which should be neither a cost nor income for them, but costs permanently arise from these activities and are covered by taxpayers.

Strict interpretations of VAT law (Bogovac et al., 2017) that ignore the principle of neutrality for taxpayers, increase the costs of tax compliance and later, in the case of disputes, make these expenditures a considerable waste of time and money for both enterprises and public bodies. Harmonisation in the field of taxation effected by the Court of Justice of the European Union in its decisions is, therefore, of paramount importance for the competitiveness of European business taxpayers.

The *ENERGOTT* case (C-643/20) brought before the Court of Justice of the European Union the topic together with the statute of limitations that had been explained previously under the principle of neutrality, in specific circumstances, in *Biosafe* (Case C-8/17). The dispute in the main proceedings and the questions referred for a preliminary ruling concerned the correction of an invoice issued by Biosafe to its customer, Flexipiso (both VAT taxpayers in Portugal) in accordance with the tax audit's findings. Biosafe paid additional VAT by virtue of this correction, but Flexipiso refused to pay the VAT calculated on debit notes on the grounds that it would be impossible to deduct it due to the expiration of the limitation period. The court of first instance approved that argument, but the Supreme Court decided to refer the questions to the Court of Justice for a preliminary ruling. The CJEU decided in favour of the common system of value added tax and the principle of fiscal neutrality, pointing out that:

> ...the right of taxable persons to deduct the VAT due or already paid on goods purchased and services received as inputs from the VAT which they are liable to pay is a fundamental principle of the common system of VAT established by EU legislation... (C-8/17, para. 27).
>
> The deduction system is intended to relieve the operator entirely of the burden of the VAT due or paid in the course of all his economic activities. The common system of VAT therefore ensures neutrality of taxation of all economic activities, whatever their purpose or results, provided that they are in principle themselves subject to VAT (C-8/17, para. 28).

It was also important for this case that the purchaser did not show any lack of diligence before the receipt of the debit notes, and failing any abuse or fraudulent collusion with the seller (C-8/17, para. 43), the buyer was given the right to deduct the input VAT, which cannot be denied by referring to the statute of limitations which had expired for the original invoice.

Different circumstances in the *ENERGOTT* case with regard to the limitation period (C-643/20) are explained further in the text.

The *ENERGOTT* case (C-643/20)

Related to the correction of the tax base in the case of impossibility of collection, the national court in Hungary (the Veszprémi Törvényszék) lodged a Request for a preliminary ruling (hereinafter: the Request) to the EU Court. The parties to the main proceedings are ENERGOTT Fejlesztő és Vagyonkezelő Kft. as applicant, and Nemzeti Adó- és Vámhivatal Fellebbviteli Igazgatósága as defendant.

Under the Request, the EU Court is asked to answer the following questions (C-643/20, Request):

> 1. Must Article 90(1) and (2) of Council Directive 2006/112/EC of 28 November 2006 on the common system of value added tax (the

VAT Directive), be interpreted, having regard in particular to the judgment of 23 November 2017, Di Maura (C-246/16), the order of 29 January 2020, Porr Építési Kft. (C-292/19), and the fundamental principles of the effectiveness of the EU law and of equivalence, as meaning that Member States cannot set as the starting point of the limitation period, for the purposes of the repayment of VAT relating to debts which have become definitively irrecoverable, a date prior to that on which the debt forming the basis of the VAT repayment application becomes irrecoverable?

2. Must Article 90(1) and (2) and Article 273 of the VAT Directive be interpreted, having regard in particular to the judgment of 23 November 2017, Di Maura (C-246/16), the order of 29 January 2020, Porr Építési Kft. (C-292/19) and the fundamental principles of the effectiveness of the EU law, equivalence and tax neutrality, as meaning that the practice of a Member State, whereby, in the context of the repayment of VAT relating to debts which have become irrecoverable and provided that that tax can be repaid, the authorities of the Member State responsible for applying the legislation require that, in addition to lodging a claim for the debt to which that tax relates in a winding-up procedure, the taxable person take further steps to settle that debt, is contrary to those principles?

3. Must Article 90(1) and (2) and Article 273 of the VAT Directive be interpreted, having regard in particular to the judgment of 23 November 2017, Di Maura (C-246/16), the order of 29 January 2020, Porr Építési Kft. (C-292/19), and the fundamental principles of the effectiveness of the EU law, equivalence and tax neutrality, as meaning that the legal practice of a Member State, whereby, in the event of non-payment, the company that provides the service in question must immediately cease to provide it since, by failing to proceed thus and instead continuing to provide that service, it will not be able to recover the VAT corresponding to the debts which have become definitively irrecoverable despite the fact that the impossibility of recovery arose subsequently, is contrary to the aforementioned provisions?

4. Must Article 90(1) and (2), Article 273 of the VAT Directive, and Articles 15 to 17 of the Charter of Fundamental Rights of the European Union be interpreted, having regard in particular to the judgment of 23 November 2017, Di Maura (C-246/16), the order of 29 January 2020, Porr Építési Kft. (C-292/19), and the fundamental principles of the effectiveness of the EU law, equivalence and tax neutrality, as meaning that the authorities of the Member State responsible for applying the legislation have established the requirements set out in Questions 2 to 4 referred for a preliminary ruling without any legal basis further to the judgment in Porr Építési Kft. (C-292/19), and that those conditions were not clear to the taxable persons concerned before those debts became definitively irrecoverable?

Circumstances of the case

The national court in Hungary in its Request explained the circumstances of the case and its point of view. To determine tax treatment, it is necessary to consider all those circumstances of the case set out by the national court in its Request. It is stated (C-643/20, Summary of the facts, para. 1) that the ENERGOTT group, as a prominent operator in the Hungarian energy sector, provides public services to the population (for example, supplies of drinking water and hot water, electricity generation, district heating, and sanitation and municipal services). A high proportion of the applicant's trading partners are companies directly or indirectly under municipal ownership, to which ENERGOTT supplied services provided for in legislation which did not allow it to suspend supply in the event of non-payment. The applicant issued invoices for services supplied to seven debtors which, in the period when the taxable transactions occurred, had valid tax numbers and were not involved in

any bankruptcy, liquidation, or judicial winding up proceedings (C-643/20, Summary, para. 2). The debtors did not pay the invoices and, in the meantime, two of them were dissolved, one was wound up by court order and another three became the subject of liquidation proceedings. Even though the unpaid claims against those three companies were in all the cases notified in the liquidation proceedings, the majority of the claims were not recovered, or were recovered only to a minimal amount, due to insufficient resources; the debts, therefore, became definitively irrecoverable (C-643/20, Summary, para. 3). The applicant accounted for and declared the tax due in the assessment periods which were applicable based on the dates of the invoices confirming the provision of the services (C-643/20, Summary, para. 4). It filed an application for a refund of the sum of HUF 76,565,379 in respect of VAT previously paid, included on the invoices issued in relation to the debts which had become irrecoverable, and for the payment of the accrued interest. The company based its application on the judgment of the EU Court in Di Maura (C-246/16) and the order in Porr Építési Kft. (C-292/19). The applicant also requested the *ex officio* calculation of interest on the VAT to be recovered, in so far as the due date for payment of the VAT preceded the date of effective payment of the amount thereof (C-643/20, Summary, para. 5). The first-tier tax authority declared that the right to an assessment of the tax had lapsed in respect of a total VAT amount of HUF 73,208,755 (C-643/20, Summary, para. 8). With regard to an invoice including VAT in the amount of HUF 2,882,736, the first-tier tax authority found that, when it came to payment of that invoice, the taxable person had not properly asserted its right and, therefore, its application in respect of that sum was also rejected (C-643/20, Summary, para. 9). The first-tier tax authority examined the invoices in respect of which the right to an assessment of the tax had not lapsed and found that the VAT on those invoices was definitively irrecoverable. However, the first-tier tax authority held, as regards the invoices issued for payment by the companies in respect of which liquidation proceedings had been initiated, that the taxable person had not established that it had taken all the necessary steps for the recovery or payment of its claims, meaning that it had not properly asserted its right, and, consequently, the tax authority also rejected the taxable person's application in relation to the refund of VAT in the amount of HUF 3,356,625 (C-643/20, Summary, para. 10). However, the first-tier tax authority declared that the taxable person was also entitled to a VAT refund of HUF 473,889 in respect of the invoice issued for payment by one company in terms of which liquidation proceedings had been initiated (C-643/20, Summary, para. 11). The applicant lodged an administrative appeal against that decision (C-643/20, Summary, para. 12). The defendant second-tier tax authority, which was seised of that appeal, confirmed the contested decision (C-643/20, Summary, para. 13). In its opinion, it is not possible to examine the conditions for the refund of the tax in respect of a time-barred period, and, therefore, it is not lawful to seek a refund of the tax by making a claim or by filing a supplementary return. Thus, according to the second-tier tax authority, the taxable person's argument that the limitation period starts to run when the debt becomes irrecoverable is groundless (C-643/20, Summary, para. 17). The second-tier tax authority went on to examine the invoices which were not time-barred. In that connection, during its examination, the second-tier tax authority checked, first, whether the taxable person had established that the debts had definitively acquired the status of 'irrecoverable'. In the instances where the taxable person had established that recovery was impossible but had not taken all the steps which could be expected of it to ensure that its trading partner settled the debt or, in the absence of payment, failed to terminate the business relationship, trusting, without any reason to do so, that the debts would be paid off, the second-tier tax authority confirmed that the first-tier tax authority had lawfully refused to grant the applicant the VAT refund (C-643/20, Summary, para. 19). During the proceedings, the second-tier tax authority found, in relation to unpaid invoices issued for payment by two of the applicant's

trading partners, that those invoices did not refer to services which could be linked to the performance of a public service, and, therefore, the applicant had no legal obligation to provide those services or to continue doing so if its trading partner failed to pay for them. The second-tier tax authority also pointed out that the applicant had not sent payment requests to its trading partners despite the fact that this was appropriate even where there was a legal obligation to supply the service (C-643/20, Summary, para. 20). The applicant contested those decisions in administrative proceedings (C-643/20, Summary, para. 23).

The position of the court making the Request

The referring court takes the view that it is unable to adjudicate on the dispute between the parties without an interpretation of the EU law, specifically Article 90(1) and (2) of the VAT Directive (C-643/20, Summary, para. 40).

The question referred for a preliminary ruling in this case does not ask the Court to interpret the Hungarian limitation rules but rather to examine the application of Article 90 of the VAT Directive in the light of two principles of the EU law, namely:

- the principle of effectiveness, and
- the principle of equivalence (C-643/20, Summary, para. 46).

The referring court pointed out that the question arises in this case whether, based on the Hungarian concept of limitation, it is possible to refuse to grant the applicant a subsequent reduction of its taxable amount pursuant to Article 90 of the VAT Directive and, therefore, a reduction of the tax owed, on the basis that, according to the tax authority's practices, the limitation period commences when taxable persons cannot yet even foresee the impossibility of recovering their claims and the right to a refund which flows from that impossibility. The referring court considers that, for the purpose of adjudicating on the dispute, it is necessary to determine whether, in the absence of national legislation, the practices of the tax authority of a Member State make it possible to lay down *a posteriori* a number of procedural conditions which must be fulfilled in order to exercise the right to a reduction of the taxable amount for VAT; that is, whether it is possible to lay down a set of conditions for establishing the existence of that right (C-643/20, Summary, para. 47). The referring court considers that the FGSZ case, which was pending before the Court at the time of the application, concerns the fundamental principles of proportionality, tax neutrality and effectiveness, but it differs from the present case in terms of its facts, since that case does not examine the set of conditions linked to the requirement that a right must be properly asserted, from which it follows that it cannot relate to the principle of equivalence, either (C-643/20, Summary, para. 48).

Analysis

Given the previous cases of the EU Court, the case in question can be analysed in two segments:

- the statute of limitations, and
- the application of the provision on the correction of the tax base.

The statute of limitations

In the FGSZ case, mentioned by the referring court in its Request, the EU Court made a decision in the meantime. Therefore, the application of a limitation period has already been reviewed by the EU Court in its judgment of 3 March 2021, FGSZ (C-507/20). According to the decision of the EU Court in that case:

> ...article 90 of the VAT Directive, read in conjunction with the principles of fiscal neutrality and effectiveness, must be interpreted as meaning that, where a Member State lays down a limitation period after which a taxable person, who has a debt which has become

definitively irrecoverable, can no longer assert his right to obtain a reduction in the taxable amount, that limitation period must begin to run not from the date of performance of the payment obligation initially provided for, but from the date on which the debt became definitively irrecoverable (C507/20, Decision).

In this sense, it is possible to apply this decision of the EU Court to the first question in the Request. The point is that the right to a refund could not have become obsolete before it was exercised. Therefore, the statute of limitations in respect of a right to a VAT refund based on a correction of the tax base may start to run only after the taxpayer acquires such a right.

The application of the provision on the correction of the tax base

The remaining three questions regarding the application of the provision on the correction of the tax base should be analysed together. Basically, the aim is to determine whether the authority's practices are in line with Article 90 (1) and (2) and Article 273 of the VAT Directive, having regard to the fundamental principles of the effectiveness of the EU law, equivalence and tax neutrality, when they established the requirements, even when those conditions were not clear to the taxable persons concerned before those debts became definitively irrecoverable, such as:

- in addition to lodging a claim for the debt to which that tax relates in a winding-up procedure, the taxable person should take further steps to settle that debt; and
- in the event of non-payment, the company that provides the service in question must immediately cease to provide it since, by failing to proceed thus and instead continuing to provide that service, it will not be able to recover the VAT corresponding to the debts which have become definitively irrecoverable despite the fact that the impossibility of recovery arose subsequently.

According to the case-law of the Court, in the situations covered by that provision, Article 90(1) of the VAT Directive requires Member States to reduce the taxable amount and, consequently, the amount of VAT payable by the taxable person whenever, after a transaction has been concluded, part or all of the consideration has not been received by the taxable person. That provision embodies one of the fundamental principles of the VAT Directive, according to which the taxable amount is the consideration actually received and the corollary of which is that the tax authorities may not collect an amount of VAT exceeding the tax which the taxable person received (C-404/16, para. 26). However, Article 90(2) permits Member States to derogate from the above-mentioned rule in the case of total or partial non-payment of the transaction price (C-404/16, para. 27 and C-337/13, para. 23). The power to derogate, which is strictly limited to the situation of total or partial non-payment of the transaction price, is based on the notion that in certain circumstances, and because of the legal situation prevailing in the Member State concerned, non-payment of consideration may be difficult to establish or may only be temporary (C-404/16, para. 28). Unlike refusal or cancellation of the contract, non-payment of the purchase price does not restore the parties to their original position. If the total or partial non-payment of the purchase price occurs without there being cancellation or refusal of the contract, the purchaser remains liable for the agreed price and the seller, even though no longer the proprietor of the goods, in principle continues to have the right to receive payment, which the seller can rely on in court. Since it cannot be excluded, however, that such a debt will become definitively irrecoverable, the EU legislature intended to leave it to each Member State to decide whether the situation of non-payment of the purchase price leads to an entitlement to have the taxable amount reduced accordingly under conditions it determines, or whether such a reduction is not allowed in that situation (C-404/16), para. 29 and C-337/13,

para. 25). Non-payment is characterised by the inherent uncertainty that stems from its non-definitive nature (C-404/16, para. 30).

In this regard, national VAT provisions relating to the VAT Directive should be analysed in order to determine possible conditions for the application of the tax base adjustment. In that sense, it should be pointed out that Hungary possibly applied the derogation from the correction of the tax base in the case of the impossibility of collection, according Article 90(2) of the VAT Directive, in the referred period. What consquences this fact has on the tax treatment in this case should be analysed in more detail.

Thus, according to the Request, the relavant provision of national law is Article 77(1) to (10) of the Law CXXVII of 2007 on value added tax (hereinafter: the VAT Law). This article is mentioned in the judgment of 15 May 2014, Almos Agrárkülkereskedelmi Kft (C-337/13, para. 7), as follows:

Under Paragraph 77 of Law CXXVII of 2007 on VAT...:

> (1) In the case of the supply of goods or services or intra-Community acquisitions of goods, the taxable amount is reduced subsequently by the amount of the consideration which is repaid or to be repaid to the person entitled if, following completion of the transaction:
> (a) where the transaction is invalid:
> (aa) the situation obtaining before the completion of the transaction is restored, or
> (ab) the transaction is declared to have had effects in the period preceding the decision declaring that it is invalid;
> (ac) the transaction is declared valid by way of elimination of a disproportionate advantage;
> (b) where there are failures in the completion of the transaction:
> (ba) the transaction is cancelled by the person entitled;
> (bb) the person entitled is given a price reduction.
> (2) The taxable amount is also reduced subsequently where:
> (a) the amount advanced is repaid because the transaction is not completed;
> (b) in the case of the supply or hire of goods referred to in Paragraph 10(a), the tax debtor exercises his right to cancel as a result of the failure to pay the consideration in full and the parties restore the situation existing before completion of the transaction, or, if that is not possible, recognise that the transaction had effects until the time of the failure;
> (c) in the case of goods on which a deposit is paid, the amount paid by way of deposit is returned.
> (3) The taxable amount may be reduced subsequently in the case of a price reduction, in accordance with Paragraph 71(1)(a) and (b), following completion of the transaction.

Reading this provision it could be concluded that Hungary did apply derogation from the adjustment of the tax base in the case of non-payment. As the EU Court pointed out:

> ...a national provision which, in setting out the situations in which the taxable amount is reduced, does not refer to the situation of non-payment of the transaction price must be regarded as the result of the exercise by the Member State of the power of derogation granted it under Article 90(2) of the VAT Directive (C-337/13, para. 24).

A similar version of that provision is set out in the judgment of 12 October 2017, in the *Lombard Ingatlan Lízing Zrt*. case (C-404/16 para. 6).

However, according to unofficial data, as a result of legislative changes in Hungary, the correction of output VAT on uncollected receivables becomes possible under certain conditions from 2020. This applies to B2B accounts in which the date of supply falls after 31 December 2015. This case concerns uncollected receivables for services performed before 2015.

Accordingly, there is a high probability that Hungary did apply derogation from the rule of the adjustment of the tax base in the case of non-pay-

ment in the referring period. To be certain about this conclusion, we should ask the Hungarian tax authority for their legal opinion or wait for a judgment in this case. In this sense, the case should be analysed accordingly.

In the event that Hungary probably did apply the derogation and did not permit the adjustment of the tax base in the case of non-payment, we should consider the order of 29 January 2020, Porr Építési Kft. (C-292/19), which the applicant cited in its lawsuit. In that case, the EU Court considered that derogation from the adjustment of the tax base in the case of non-payment is not aplicable in the case of final inability to collect.

The power to derogate in the case of total or partial non-payment is based on the notion that in certain circumstances, and because of the legal situation prevailing in the Member State concerned, non-payment of consideration may be difficult to establish or may only be temporary (C-127/18, para. 19). It follows that the exercise of that power must be justified if the measures taken by the Member States for its implementation are not to undermine the objective of fiscal harmonisation pursued by the VAT Directive and it cannot allow the Member States to exclude altogether the reduction of the VAT taxable amount in the event of non-payment (C-127/18, para. 20; C-246/16, Judgment, para. 18, 20 and 21; C-396/16, Judgment, para. 38). Although it is relevant that Member States may counteract the uncertainty as to the non-payment of an invoice or the definitive nature of that non-payment, such a power of derogation cannot extend beyond that uncertainty, and, in particular, cannot extend to whether a reduction of the taxable amount may not be carried out in situations of non-payment (C-127/18, para. 21; C-246/16, Judgment, para. 22; C-396/16, Judgment, para. 40). To accept that it is possible for Member States to exclude any reduction of the VAT taxable amount would run counter to the principle of the neutrality of VAT, which means, *inter alia*, that the trader, as tax collector on behalf of the State, is entirely to be relieved of the burden of tax due or paid in the course of its economic activities which are themselves subject to VAT (C-127/18, para. 22; C-246/16, Judgment, para. 23). A situation characterised by the definitive reduction in the debtor's obligations towards its creditors cannot be classified as *non-payment* within the meaning of Article 90 (2) of the VAT Directive (C-292/19, para. 25; C-396/16, paras. 44 and 45). More specifically, the Court ruled, after having noted that the fact that the debtor has ceased to be subject to VAT in the context of insolvency proceedings is capable of corroborating the final nature of the non-payment, that Article 90 of the VAT Directive precludes national legislation which provides that the taxable person cannot rectify the tax base for VAT, in the event of total or partial non-payment by the debtor, of an amount due in respect of a transaction subject to this tax, if this debtor is no longer subject to VAT (C-292/19, para. 26 and C-127/18 paras. 24 and 28). If the debt declared by the appellant is thus now definitively irrecoverable, the reduction in the debtor's obligations which results from the proceedings for insolvency does not constitute a case of non-payment and this does not give rise to a reduction in the tax base for VAT where the Member State has exercised the option of derogation provided for in Article 90(2) of the VAT Directive (C-292/19, para. 28).

Accordingly, in the event of final debt default, a Member State cannot apply a derogation from the adjustment of the tax base.

Furthermore, it is necessary to consider the conditions that the Member State subsequently imposed on the taxpayer in order to correct the tax base. According to the EU Court, the objective of preventing irregularities and abuses does not allow Member States to contravene the purpose and scheme of Article 90(2) of the VAT Directive and to justify a derogation from Article 90(1) of that directive on the grounds other than those relating to uncertainty as to the non-payment or the definitive nature of that non-payment (C-335/19, para. 44; C-127/18, para. 25). In accordance with the principle of proportionality, which is one of the general principles of the EU law, the means employed to implement the VAT Directive must be appropriate to achieve the objectives stated in that directive and must not go beyond what is

necessary in order to attain them (C-335/19, para. 47; C-246/16, para. 25). In the judgment of 15 October 2020, *E. sp. z o.o. sp. k.* (C-335/19), the EU Court pointed out that where a taxable person does not satisfy the conditions laid down by national legislation, which do not comply with Article 90(1) of the VAT Directive, it may rely on that provision before the national courts against the State in order to obtain a reduction in the taxable amount, it being for the national court before which proceedings have been brought to set aside those conditions which do not comply with Article 90(1) of the VAT Directive. The fact that, in so doing, other provisions of national law are affected is irrelevant, otherwise the obligation for national courts to disapply a provision of national law which is contrary to a provision of the EU law which has direct effect would be rendered meaningless, thereby undermining the primacy of the EU law (C-335/19, para. 52; C-337/13, para. 35). The answer to the questions referred to in that case is that:

> Article 90 of the VAT Directive must be interpreted as precluding national legislation which makes the reduction of the VAT taxable amount subject to the condition that, on the day of delivery of the goods or provision of the services and on the day preceding that on which the adjusted tax return seeking that reduction is filed, the debtor is registered as a taxable person for the purposes of VAT and is not the subject of insolvency or winding-up proceedings, and that, on the day preceding the date of filing of the adjusted tax return, the creditor is itself still registered as a taxable person for the purposes of VAT (C-335/19, para. 53).

In the light of the foregoing, it is for the national court in this case to ascertain whether the conditions subsequently imposed on the taxpayer for the purpose of adjusting the tax base comply with the principle of proportionality, that is to say, whether they go beyond what is necessary.

There is also the question of a principle not set out in the Request, which is the protection of legitimate expectations. In this regard, it is also possible to expect that the EU Court could itself refer to this aspect in the present case. In this sense, the EU Court pointed out in its judgment of 9 July 2015, *Salomie and Oltean* (C-183/14), that in relation to the principle of the protection of legitimate expectations, the right to rely on that principle extends to any person in a situation in which an administrative authority has caused that person to entertain expectations which are justified by precise assurances provided to him or her. In this regard, it is necessary to determine whether the conduct of an administrative authority has given rise to a reasonable expectation in the mind of a prudent and well-informed trader and, if it did, the legitimate nature of that expectation must then be established (C-183/14, paras. 44 and 45).

Conclusion

In accordance with the existing case-law of the EU Court, in this case it is likely that the statute of limitations will not affect the decision on the right to correct the tax base and the refund of the corresponding VAT. Regarding the right to a correction of the tax base, it is largely conditioned by the determination of whether Hungary applied a derogation from the correction of the tax base in the event of the impossibility of collection in the period in question. If so, then it will be crucial for the decision on the right to adjust the tax base to determine whether these are finally uncollectible receivables. The conditions imposed retroactively by a Member State on a taxpayer, according to the views expressed by the EU Court in cases unrelated to the issue in question, should in principle not affect the exercise of the right to a correction of the tax base.

This case is important for practice, especially for entrprises which, in the case of a positive response to the applicant's request, would be allowed a VAT refund under similar circumstances. In such a case, VAT would not burden their business, and VAT would remain neutral for entreprises.

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