

## **Basic Features of VAT**

### **Part Two.**

#### **Neutrality via the net all-phase principle with input tax deduction**

The common VAT system is based on the following principle: Each taxable company in the supply chain *calculates the sales tax based* on the consideration it receives from its respective customer at the tax rate applicable to the delivery or service provided. At the same time, it determines *the previous sales that it used to carry out its deliveries and provision of its services*, and the sales tax that was billed to it for this. *It deducts this sales tax from its tax liability as input tax.* The difference is paid as a payment burden to the tax office. The common VAT system is applied up to the retail level. The subjective right to deduct input tax must be assessed individually at all levels along the service chain. The person who is economically *burdened by VAT (taxpayer) is the end consumer.* The burden on final consumption is achieved by eliminating the input tax deduction at the end-user level. The input tax deduction along the business chain ensures that the VAT burden on the end consumer is *independent of how many stages of production and distribution a product has gone through.*

As a self-declaration tax, VAT is prone to failure to a not inconsiderable extent. On the one hand, there is the risk that the VAT on a company's *output sales will not be declared or paid.* On the other hand, there is a far greater risk that *input tax will be “fraudulently obtained”* and paid out without the state even collecting the corresponding sales tax. This has made VAT in its current form of collection highly susceptible to fraud until introducing

the online invoicing enabling the tax office to follow each stage of the transaction electronically.

According to the case law of the ECJ, VAT has four structural characteristics:

1. *General application of the tax for all transactions* relating to goods and services;
2. Determination of their amount *proportional to the price* that the taxpayer receives in return for the goods or services;
3. *Collection of taxes at every stage of production* and distribution, including the retail stage, regardless of the number of previous sales;
4. *Deduction of the tax amounts already paid on the previous levels* from the tax owed by the taxpayer, so that the tax at a certain level only relates to the added value at this level and the burden is ultimately borne by the consumer.

These basic principles are often summarized as **VAT neutrality**.

On the one hand, the principle of neutrality *implies the prohibition of distortions of competition* in the internal market. Similar and competing services must not be treated differently when collecting VAT. The economic activities are to be taxed *in a completely neutral way regardless of their purpose and their result*. This means that the national tax law is assigned, and the tax base is determined *in the same way in all Member States*.

On the other hand, the principle of neutrality says that VAT must have a *cost-neutral effect* within the business chain, as it is borne by the end consumer. The national statutory provisions must ensure *complete relief from input tax within the business chain*. The cost-neutral treatment of VAT is made possible by the *open tax pass-through* and the *right to*

*input tax deduction*. Even the entrepreneur with no turnover is in principle entitled to input tax deduction. In the case of “false” tax exemptions, however, input tax deduction can also be refused within the business chain and thus VAT can accumulate. Charging illegitimately exempted services with “hidden” sales tax (“taxe occulte”) is intended by the system and compatible with the principle of neutrality.

In the practical application of the common VAT system, the principles of legal certainty and proportionality must be observed as further basic principles and the fundamental freedoms of the EC Treaty must be guaranteed. This also includes the free movement of goods.

Unlike customs law or European export refund law, sales tax law does not have the character of a criminal or sanction. The fact that in the case law of the ECJ on VAT there are nonetheless considerations of sanctions law ultimately has to do with the abuse clause of Community law derived from general legal principles.

*As experts in VAT law* we are ready to work with you. ***Get in touch!***

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