Hungary: Case C-596/19 P European Commission v Hungary – Opinion of Advocate General Kokott

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1. Introduction

The Hungarian advertisement tax provides for yet another aspect of the controversy that swirls around turnover-based taxes. The stringent procedural rules of the same tax have already been subject to scrutiny under the prism of the non-discrimination clause of a double tax convention[1] and of the EU fundamental freedom provisions.[2] The present case concerns the State aid compatibility of the substantive rules of the advertisement tax, namely its progressive tax rate structure and its special tax-loss carry-forward rules. The examination of progressive turnover-based taxes in light of the State aid rules has been timely as in academic literature, several scholars have expressed their concerns that such taxes might amount to prohibited State aid under Article 107 of the TFEU.[3] The question of compatibility of progressive turnover-based taxes with the State aid rules was already raised before the Court of Justice of the European Union (CJEU or Court) in the context of the Hungarian telecommunications and store retail trade taxes. However, the CJEU found the question inadmissible, leaving this intensely discussed query unanswered.[4] Hopefully, the future judgment of the CJEU in the present case will bring about a clear-cut answer. It would be particularly desirable in light of the current tax policy trends when more and more Member States introduce some form of turnover-based taxes with progressive tax rates, most notably some variations of digital services taxes.[5] The potential conflict of those taxes with EU law can have a significant impact throughout the EU, putting an end to the increasing popularity of taxes with such a design.

The structure of this contribution is the following. In Chapter 2, the relevant rules of the advertisement tax will be presented, then in Chapter 3, the short overview of the previous steps of the underlying legal procedure will be highlighted, briefly mentioning the main points of the negative decision of the Commission of the European Union (Commission) and those of the General Court's judgment. After-

1 AB Decision, [Constitutional Court], 28 Nov. 2017, 31/2017. (XII. 6.), in respect of the non-discrimination clause of the Hungary-Ireland Double Tax Convention.

2 CJEU, 3 March 2020, C-482/18, *Google Ireland Limited v Nemzeti Adó- és Vámhivatal Kiemelt Adó- és Vámigazgatósága.*, ECLI:EU:C:2019:728.

3 J.F.P. Nogueira: The Compatibility of the EU Digital Services Tax with EU and WTO law: Requiem Aeternam Donate Nascenti Tributo, International Tax Studies, 2019 (Volume 2), No. 1, IBFD; R. Mason & L. Parada: Digital Battlefront in the Tax Wars, 92 Tax Notes Int'l 1183 (2018); R. Szudoczky & B. Károlyi: Progressive Turnover Taxes under the Prism of State Aid, EStAL, Vol.19, No. 3, 2020.

4 CJEU, 3 March 2020, C-75/18, *Vodafone Magyarország*, ECLI:EU:C:2020:139; CJEU, 3 March 2020, C-323/18, *Tesco-Global Áruházak*, ECLI:EU:C:2020:140. For a critical analysis of the CJEU's approach on the admissibility of State aid questions referred by the domestic courts in cases concerning an individual tax notice, see: R. Szudoczky & B. Károlyi: To Admit, or Not to Admit, That Is the Question – The CJEU's Controversial Stance on the Admissibility of State Aid Questions in Preliminary Ruling Procedures, Kluwer Tax Blog, Available at: http://kluwertaxblog.com/2020/03/31/to-admit-or-not-to-admit-that-is-the-question-the-cjeus-controversial-stance-on-the-admissibility-of-state-aid-questions-in-preliminary-ruling-procedures/?print=print (last accessed: 30 Nov. 2020)

5 S. Kirchmayr, S. Geringer: 'State Aid Issues Regarding National Digital Taxes', (2020) European Taxation, Volume 60, No. 7, p. 1.

wards, in Chapter 4, the opinion of Advocate General Kokott will be discussed in detail, and the conclusion will be summarized in Chapter 5.

2. The relevant rules of the advertisement tax

The advertisement tax was enacted in the Hungarian tax system in 2014. The tax is levied on the annual net turnover of taxpayers generated by the publishing of advertising in exchange for consideration, including publishing on the internet, or broadcasting/displaying on media platforms and traditional platforms such as cars, real estate and outdoor advertising surfaces. The taxable person, the scope of which covers both natural persons and legal entities, is the publisher who has the right to control the advertising space.

The advertisement tax was originally levied at steeply progressive rates. In particular, six tax bands were created, and the tax rates ranged between 0% and 40%. As of 2015, the tax rate applicable to the highest band was increased to 50%, and the rate structure was determined in following way:

- turnover below HUF 0.5 billion: 0%;
- between HUF 0.5 billion and 5 billion: 1%;
- between HUF 5 billion and 10 billion: 10%;
- between HUF 10 billion and 15 billion: 20%;
- between HUF 15 billion and 20 billion: 30%;
- and above HUF 20 billion: 50%.

As mentioned in the introduction, one of the grounds for the Commission's State aid investigation was this steeply progressive tax rate structure. Following the Opening Decision of the Commission, Hungary amended the rules on the advertisement tax in June 2015 so that it introduced a dual tax rate structure of 0% up to HUF 100,000,0000 and 5.3% for the exceeding part of the turnover. The amendment entailed the optional retroactive application of the new rules from the entry into force of the tax in 2014. The Commission considered in its Final Decision[6] that this amendment only partially addressed the originally raised concerns; the tax rate structure remained progressive without proper justification. Therefore, it did not affect the Commission's conclusion that the advertisement tax due, inter alia, to its progressive tax rate constituted State aid.[7] The tax rate was further modified effective from 1 July 2017, which nevertheless maintained the dual structure: zero-rate for turnover up to a threshold of HUF 100,000,000 and a rate of 7.5% for the part of the turnover exceeding the threshold. In this new form, the exemption resulting from the zero-rate bracket is provided under the EU *de minimis* aid regime thus it should not raise any State aid concern in the fu-

6 HU: Commission Decision (EU) 2017/329 of 4 Nov. 2016 on the measure SA.39235 (2015/C) (ex 2015/NN) implemented by Hungary on the taxation of advertisement turnover, OJ L 49/36.

7 Commission decision, *supra n.* 6, para. 86.

ture. The most recent amendment temporarily reduced the tax rate to 0% irrespective of the level of turnover; thus the advertisement tax liability is practically suspended until the end of 2022.

The Act on advertisement tax also contained a provisional tax-loss carry forward rule that allowed the deduction of 50% of the corporate income tax losses from the advertisement tax base for 2014, however, only for those taxpayers that have not made any profits in 2013 for income tax purposes. Although the eligibility criterion was solely related to the 2013 economic result of the taxpayers, once they qualified, they were entitled to deduct all the losses carried forward, not only those that were suffered in 2013. These rules excluded companies that carried forward losses from previous tax years but were profit-making in 2013. Furthermore, being a provisional measure, the tax-loss carry-forward rules were only applicable in the tax year of 2014.

3. The previous steps of the underlying legal procedure

3.1. The Commission's Decision

The Commission's Final Decision contained the obligation of the recovery of State aid or, as an alternative, the abolition of tax liability with retroactive effect. Hungary chose the second option and, as a consequence, the outstanding tax liability was cancelled up to July 2017. The tax already paid in this period was booked as overpayment of the tax levied according to the modified rules.

The Commission started a formal State aid investigation with regard to the advertisement tax in 2015. In its Final Decision in 2016, it concluded that the advertisement tax entailed unlawful State aid due to its progressive tax rate structure and its loss carry-forward rules that allowed the deduction of losses incurred for corporate income tax purposes from the advertisement tax base but limited the deduction in several ways in time and otherwise. Overall, these provisions of the advertisement tax conferred a selective advantage on advertisement companies with a lower level of turnover (and thus smaller undertakings) in the form of lower average tax rates and on undertakings that were loss-making in 2013 and could thus offset carried-forward losses.

The Commission stated that the advantage of lower applicable average tax rates is selective because, in the context of the advertisement tax, the objective of which is public burden sharing, all operators subject to the tax are in a comparable legal and factual situation and, therefore, should pay the same proportion of their turnover regardless of its level. Thus, the progressive rate cannot be part of the reference system of the special turnover tax; rather, it is a derogation from the reference system. Such a derogation cannot be justified by the nature and general scheme of the system, in particular, by the aim of collecting revenue and public

burden sharing. The Commission added that, in its view, progressive rates for turnover taxes are justified only in exceptional cases. Such would be the case *'if the externalities created by an activity that the tax is supposed to tackle also increase progressively – i.e. more than proportionately – with its turnover'*.[8]

The Commission examined the special tax-loss carry-forward rules in light of the State aid provisions and considered them as conferring a selective advantage, thus qualifying as incompatible State aid. It concluded that the relevant rules could not be considered as part of the reference system because costs, including losses, are normally not deductible from turnover tax bases. Furthermore, these provisions created arbitrary differentiation between groups of taxpayers who were in a comparable legal and factual situation in light of the objective of the these rules. The possibility of deducting the tax losses carried forward had been restricted to undertakings that were not profit making in 2013.

3.2. Judgment of the General Court

Although Hungary repealed the advertisement tax liability with a retroactive effect, it also appealed against the decision of the Commission. As a consequence, the General Court annulled the Commission's decision[9] and stated that when it comes to the determination of the common or normal system of taxation, it is not possible to exclude certain tax rates from the substance of a system of taxation. The tax rates form part of the fundamental characteristics of a tax levy's legal regime irrespective of whether they are levied at a single rate or at a progressive scale. The General Court highlighted that the Commission's approach identifying the general tax system as one with a single rate without exemption would amount to a merely hypothetical system. The selectivity of a tax measure should be investigated by considering the actual characteristics of the 'normal' system of taxation of which it forms a part, and not in light of assumptions.[10] In summary, the General Court stipulated that the normal tax system was created by the advertisement tax itself including its progressive tax rate structure.

Furthermore, the General Court identified a more specific objective of the advertisement tax than raising tax revenue, namely its redistributive purpose and taxation of taxpayers according to their ability to pay. In light of this objective, it found high-turnover and low-turnover undertakings incomparable as it was of the view that the level of turnover serves as a proxy for financial capacity.

The General Court also annulled the Commission decision with respect to the tax-loss carry-forward rules. It laconically stated that, from the point of view of the redistributive objective, undertakings that were profit making in 2013 are not

8 Commission decision, *supra n.* 6, para. 69.
9 27 June 2020, Case T-20/17 *Hungary v Commission,* ECLI:EU:T:2019:448.
10 Ibid. para. 81.

in a comparable situation with those that were not. In addition, the eligibility criterion for deducting losses carried forward was considered to be objective. Therefore, as to the General Court, the loss carry-forward provisions have conferred no selective advantage.

4. Opinion of Advocate General Kokott

In accordance with the position that the Commission took in its negative Decision, the Commission submitted the following grounds of appeal against the judgment of the General Court in respect of both the progressive tax rate structure and the tax-loss carry-forward rules. First, according to the Commission, the General Court chose the incorrect reference framework; second, it carried out the comparability test in light of an incorrect non-fiscal objective; and lastly, it considered reasons that were external to the tax system in the justification phase. The analysis of the Advocate General in her opinion follows this order.

4.1. Progressive tax rate structure

4.1.1. Determination of the correct reference framework

The Advocate General started her analysis with the identification of the potential advantage conferred by the progressive rate structure. As all the undertakings benefit from the lower rates up to the level of the given turnover threshold, she pointed out that the only difference in treatment could be the different average tax rate applicable to various undertakings with different turnover level.[11]

In the second step in the analysis, Advocate General Kokott emphasized that the fiscal sovereignty of the Member States and the level of harmonization of the respective field must be taken into consideration. In the lack of harmonization, the Member States are free to design their tax systems, including the introduction of progressive taxation. Furthermore, she referred back to the judgments of the CJEU in *Vodafone* and *Tesco* cases, where the CJEU decided that progressive turnover-based taxes did not breach the fundamental freedom provisions of the TFEU because '*on the one hand, the amount of turnover constitutes a criterion of differentiation that is neutral and, on the other, turnover constitutes a relevant indicator of a taxable person's ability to pay.*'[12] According to Advocate General Kokott, the principles of these judgments apply equally to the State aid rules, and the fact that a measure was found to be compatible with the fundamental freedoms probably entails that this measure also complies with the State aid rules.[13]

11 Opinion of Advocate General Kokott, 15 October 2020, Case C-596/19 P, *European Commission v Hungary*, ECLI:EU:C:2020:835, para. 40.

12 CJEU, 3 March 2020, C-75/18, *Vodafone Magyarország*, ECLI:EU:C:2020:139; CJEU, 3 March 2020, C-323/18, *Tesco-Global Áruházak*, ECLI:EU:C:2020:140, para. 70.

13 Opinion of Advocate General Kokott, *supra* n. 11, paras. 4, 43.

This conclusion is rather surprising. Although a convergence can be discerned between the tests applied in fundamental freedoms and State aid cases in the CJEU's jurisprudence, especially when it comes to the interpretation of the discriminatory different treatment between comparable situations,[14] it does not mean that they should lead to an identical outcome. While the fundamental freedoms prohibit the overt or covert forms of discrimination against cross-border situations (foreign nationals)[15], the State aid rules prohibit the grant of all kinds of selective advantage, irrespective whether this advantage is conferred on nationals or not. Therefore, the blurred and uncertain test of nationality-based indirect discrimination does not need to be carried out in State aid cases, resulting in a wider scope of application than that of the fundamental freedoms. Consequently, the compatibility of a tax measure with the fundamental freedoms should not play a supportive, let alone a decisive role in the State aid analysis. It must be noted, however, that Advocate General Kokott continued the examination of State aid rules. Therefore, it is safe to say that she did not take into account the fundamental freedom judgments as a decisive factor, but rather as a supportive one.

Having referred to the fiscal autonomy of the Member States, the Advocate General pointed out that the reference framework or normal taxation cannot be inferred from EU law, and Member States are free to decide upon the tax base, tax rates and objectives of their domestic taxation. Therefore, the reference framework must be the advertisement tax in itself as adopted by the Hungarian legislature, including the progressive rate structure.[16] She stated that the existing reference framework could not be questioned by the Commission in order to rely on a hypothetical tax system with a single rate. No different conclusion can be inferred from the *Gibraltar* judgment either, where the Court did not change the reference framework created by the Member State, but reviewed the consistency of the design elements of the tax (basis of assessment based on payroll, business property occupation and registration fee) with the alleged objective of the tax system, namely the introduction of uniform corporate taxation. As to the Advocate General, the finding of inconsistency of the tax system amounts to the abuse of fiscal sovereignty of the Member State concerned.[17] Should the analysis conclude that the Member State implemented its taxation system inconsistently, thus designed

14 R. Szudoczky, *The Sources of EU Law and Their Relationships: Lessons for the Field of Taxation,* Doctoral Series Vol. 32 (IBFD 2014), pp. 472 and 522 et seq.

15 Most typically, when the CJEU tests whether a national measure discriminates, it compares the treatment of nationals of the given country with the treatment of foreign nationals (foreign products, service providers, workers etc.) However, the CJEU also considers the comparison of nationals who are carrying out economic activity in a purely domestic environment with nationals of the same Member State who exercise their fundamental freedoms, thus being engaged in a cross-border situation. See: A. Cordewener: *The Prohibitions of Discrimination and Restriction Within the Framework of the Fully Integrated Internal Market*, In: EU Freedoms and Taxation (ed. F. Vanistendael) EATLP Congress, 2004, IBFD, pp. 16–17.

16 Opinion of Advocate General Kokott, *supra* n. 11, paras. 44–46.

17 Ibid. para. 49.

in a way that is incapable of pursuing the underlying aims of the tax system, such a system as a general whole can amount to incompatible State aid despite the lack of any derogation (*de facto selectivity*). This was the case in *Gibraltar* where the tax structure resulted in a very low taxation of offshore companies that did not have any business properties and employees in Gibraltar; thus, they were in practice exonerated from the tax that was meant to achieve uniform corporate taxation. Such a design was manifestly inconsistent[18] with the abovementioned objective of the tax, and consequently the general reference system itself conferred a selective advantage.

As far as the advertisement tax is concerned, the same consistency test of the general reference framework must be carried out in the lack of any derogation. The Advocate General emphasized that only a manifestly inconsistent tax system could create incompatible State aid.[19] In the opinion, there is no reference to where this standard comes from.[20] The previously discussed *Gibraltar* judgment also makes no reference to any test that applies manifest inconsistency as a threshold for a general tax system to qualify as selective. In fact, there is no reference to consistency at all. What has become known as consistency test in academic literature after the *Gibraltar* judgment is a discrimination test. Accordingly, selectivity is found when a different treatment exists between undertakings, which are comparable in light of the objective of the tax system provided that such a different treatment is not a random consequence of the tax system.[21] Additionally, in general, in the jurisprudence of the CJEU, the manifestly inappropriate test can only be found when the conformity of secondary EU law legislation is under scrutiny in light of the primary EU law.[22] When it comes to the examination of national provisions, the stricter proportionality test is applied, which requires the measure at issue not only to be proportionate to its aim but also to be the least onerous one. Therefore, the manifest inconsistency test put forward by Advocate General Kokott would lower the applicable standard to a great extent, thus tilting the balance towards the sovereignty of the Member States. It would have the result that only those general tax systems would be captured by the State aid rules that are in blatant contradiction to their declared objective.

The Advocate General has defied the Commission's stance that only profit-based taxation can achieve the aim of taxation according to the ability to pay principle. She stated that profit is also just a notional parameter for ability to pay, substantiating her statement by referring to the undergoing BEPS (base erosion and profit

18 Ibid. para. 52.

19 Opinion of Advocate General Kokott, *supra* n. 11, para. 53.

20 More precisely, Advocate General Kokott referred to her former opinions in Vodafone, Tesco and ANGED cases, however, no CJEU judgments were mentioned as the source of the manifest inconsistency test.

21 CJEU, 15 Nov. 2011, Joined Cases C-106/09 P and C-107/09 *P Commission v Government of Gibraltar and United Kingdom*, paras. 101 and 106, ECLI:EU:C:2011:732.

22 7 March 2017, Case C-390/15, *Rzecznik Praw Obywatelskich (RPO),* para. 54, ECLI:EU:C:2017:174.

shifting) debates.[23] She pointed out that both turnover-based and profit-based taxation have their own advantages and flaws, but it must be considered by the legislature of the Member State and not by the Commission as State aid rules do not require the adoption of the most appropriate tax.[24] Interestingly, she regularly used the terminology of 'turnover-based income tax' when she was describing the advertisement tax that she contrasted with 'profit-based income taxes'. Conflating income taxes and turnover taxes seems to be a bold position, which must be distinguished from the original question of whether turnover can be used as a reliable proxy for measuring the financial capacity of taxpayers. That issue is not the same as whether turnover equals or approximates to income as calculated under the balance sheet method. In my view, there is a more clear-cut answer to the latter: as turnover-based taxation disregards all kind of costs and expenditures by definition, such a tax cannot be considered as a proxy for income that enables the deduction of eligible business costs. It does not mean, however, that turnover can never be an appropriate approximation for the ability to pay of the taxpayers. Observing certain sectors, one can find special patterns for average marginal profits and marginal costs. For instance, intuitively, there are always marginal costs for providing an extra unit of good for consumers in the retail sector, while it is conceivable, that certain digital services might be provided with no or minimal marginal costs.[25] When there is available data on the abovementioned profit margins and marginal costs for specific industries, then it might be possible to approximate the ability to pay of the undertakings by way of a turnover-based tax, provided that there is a relief system that eliminates double taxation in the case of income and turnover taxes being imposed simultaneously. However, though it can be precise for the sector as a whole, such tax does not help much at the level of individual undertakings that might show significant differences in respect of their profitability and consequently, of their ability to pay even within the same sector.

Following her interim conclusion that turnover as the basis of assessment was not problematic for pursuing the objective of ability to pay principle, Advocate General Kokott highlighted that the progressive rate structure did not constitute inconsistency per se either.[26] She refused the Commission's argument that progressive taxation should only be applied for natural persons in the context of income taxation due to the principle of decreasing marginal utility. The Advocate General stated that such a principle belongs to the realm of economic theory and does not qualify as a rule of law.[27] Moreover, the theory itself cannot be used for deducing the correct, precise tax rates corresponding to the ability to pay of the taxpayers. As in her previous opinions regarding the cases that addressed pro-

23 Opinion of Advocate General Kokott, *supra* n. 11, para. 58.
24 Ibid. para. 59.
25 W. Cui: The Digital Services Tax: A Conceptual Defense, Tax Law Review (forthcoming).
26 Opinion of Advocate General Kokott, *supra* n. 11, para. 61.
27 Ibid, para. 64.

gressive turnover-based taxes,[28] she did not miss to mention that the Commission's Digital Services Tax proposal contains similar design elements, i.e. it is levied on turnover (gross revenue) and results in progression by way of determining a very high turnover threshold for triggering tax liability. In light of the above analysis, she concluded that the advertisement tax has been implemented in a consistent manner.[29]

4.1.2. Comparability

According to the Advocate General, the abovementioned consistency test suffices for the examination of a national tax in light of the State aid rules where the reference framework in itself is under scrutiny. However, she continued her analysis, in the alternative, to carry out a discrimination test, that is, to assess whether the two differently treated groups, i.e. low-turnover undertakings and high-turnover undertakings are in a comparable situation. The yardstick for such a comparison must be the objective of the tax system. The Commission did not identify any more specific underlying objective of the advertisement tax than raising tax revenue and, from this point of view, it found all the taxpayers comparable irrespective of their level of turnover. By contrast, according to Advocate General Kokott, there is a more specific discernible objective, namely the taxation in accordance with the ability to pay principle and redistribution. From the perspective of this objective, undertakings with high turnover level are not comparable with low-turnover undertakings because they have different financial capacity. The Advocate General attempted to substantiate this incomparability by the arguments that large undertakings can benefit from the economies of scale, have proportionately lower costs, furthermore that high turnover is a prerequisite for high profits and marginal profit increases with falling fixed costs.[30] Consequently, she found turnover a "relevant indicator of taxable capacity"[31] and under the State aid rules, it is sufficient to conclude that the tax distinguishes between incomparable undertakings despite the fact, as she acknowledged, that profit-based income taxation with a balance sheet comparison is a more precise tool to measure the taxpaying capacity.[32]

4.1.3. Justification

After having concluded, first, that the reference framework is not inconsistent, second, that high-turnover and low-turnover undertakings are not in a compara-

28 Opinion of Advocate General Kokott. 13 June 2019, Case C-75/18, *Vodafone Magyarország* ECLI:EU:C:2019:492; Opinion of Advocate General Kokott, 4 July 2019, Case C-323/18 *Tesco-Global Áruházak*, ECLI:EU:C:2019:567.

29 Opinion of Advocate General Kokott, *supra* n. 11, para. 68.

30 Ibid, paras. 82–83.

31 Ibid, para. 82.

32 Opinion of Advocate General Kokott, *supra* n. 11, para. 84.