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Who Says a Penalty for Failing to Register for Advertisement Tax That Is Two Thousand Times Higher for Foreign Taxpayers Than the General Penalty Is Discriminatory?

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Not the Hungarian Constitutional Court but maybe AG Kokott in her forthcoming opinion in the *Google Ireland* case…

Optimistically speaking, the Hungarian Advertisement Tax contributes to a large extent to the enrichment of jurisprudence both in the field of EU law and the law of double tax treaties, as it features a host of discriminatory, distortive and arbitrary rules, which raised a record number of legal challenges against the tax. The Advertisement Tax is levied on the annual net turnover of taxpayers generated from the publishing or broadcasting of advertisement, including the publishing on the internet, on media platforms and on traditional platforms. The taxable person is the publisher, who has the right to control the advertising space. The Advertisement Tax was originally levied at progressive rates with six tax bands and rates ranging between 0% – 50%.[1] Its substantive rules, primarily its originally progressive tax rate structure has been challenged in the light of EU State aid regime[2] and their compatibility with the EU fundamental freedoms may have also been questioned, albeit this query has not been brought before the European Court of Justice (CJEU). The procedural rules of the Advertisement Tax, more specifically the registration obligation and the corresponding default penalty were examined by the Hungarian Constitutional Court under Article 24 of the Irish-Hungarian Double Tax Convention (DTC). Moreover, there is a case currently pending before the CJEU regarding the compatibility of these procedural rules with the EU fundamental freedoms and the Charter of Fundamental Rights of the European Union, i.e. the *Google Ireland* case (C-482/18).

Although the importance of the substantive issues cannot be overstated – having regard to the recent proliferation of progressive or size-based turnover taxes especially in the digital "sector", the future of which may be quite dim if progressive turnover taxes turn out to be State aid for low-turnover enterprises or indirect discrimination against foreign-owned enterprises – this note deals with the procedural issues raised by the Advertisement Tax. In particular, the question is whether a registration obligation, which, by definition, can only apply to foreign companies and a penalty, which can only hit foreign companies that fail to comply with their registration obligation and which is extraordinarily high compared to other penalties applicable to domestic taxpayers are in breach of the non-discrimination rules of either an applicable tax treaty or the EU fundamental freedoms.

The occasion for addressing this issue is the *Google Ireland* case, in which Advocate General (AG)

Kokott is expected to deliver her opinion on 12 September 2019. We attempt to predict here the outcome of the AG opinion, which is admittedly a risky endeavour. More importantly, however, we aim to show how we think this question should be analysed in the light of the EU freedoms and how such analysis should lead to the opposite result to that of the Hungarian Constitutional Court's decision. The latter found the registration obligation and the default penalty not infringing the nationality non-discrimination clause of the DTC.

About the contested rules

The registration obligation applies to all taxpayers, who have not been registered with the Hungarian Tax Authority for the purposes of any type of tax. It means that Hungarian companies are practically exonerated from this obligation because requesting a tax number and registering with the Tax Authority are inherent in the incorporation procedure of companies. Those foreign taxpayers, who are not engaged in any economic activity in Hungary, except for the advertising, have to register pursuant to this rule. In case they fail to comply with this obligation, extremely rigorous default penalty applies to them. The initial amount of the penalty is of HUF 10,000,000 (EUR 31,500) and any repeated infringement, which is established on a daily basis, entails a default penalty, which is three times higher than the amount levied for the previous offense. The aggregate amount of default penalties is capped at HUF 1,000,000,000 (EUR 3,150,000). This final amount can be reached only within 5 days.

In case the taxpayer seeks legal remedy against the imposition of the default penalty by the Tax Authority, its possibilities are much more limited than in a case where the general administrative rules apply.

No infringement of Article 24(1) according to the Constitutional Court

The Constitutional Court found that the rationale of the contested provisions was to make the taxable persons comply with their tax liability. Thus, the rules are meant to prevent tax avoidance and evasion.

The Constitutional Court acknowledged that Hungarian companies cannot be practically subject to the contested provisions as they are registered with the Tax Authority at the time of their incorporation. However, it emphasized that the purpose of the provisions is to attain the registration of foreign companies for Advertisement Tax purposes if they carry out any activity, which is liable to Advertisement Tax. The purpose of these rules is exactly to place Hungarian and foreign taxpayers on an equal footing, and to treat them in the same way for Advertisement Tax purposes. Consequently, the lack of such rules would result in different treatment between foreign and Hungarian taxpayers and would facilitate the opportunity for tax avoidance for foreign companies. As to the Constitutional Court, due to these circumstances, Hungarian and foreign taxpayers are not in a comparable situation with respect to the rules of registration and thus the different treatment of the latter does not amount to discrimination under Article 24 of the DTC.

The examination of the Constitutional Court resembles the CJEU's comparability analysis, as the Constitutional Court decided the (non)-comparability of foreign and domestic taxpayers from the perspective of the object and purpose of the domestic provisions. The Constitutional Court did not follow the strict interpretation of direct discrimination that can be deduced from the wording of Article 24(1) of the DTC and corresponding Commentary and academic literature. Taking into account this rigorous test of direct discrimination included in Article 24, we would have to arrive at

the same conclusion as the Constitutional Court, that is, the contested provisions of the Advertisement Tax Act do not breach the nationality-based non-discrimination clause of Article 24. This is so because the rules at issue do not distinguish between taxpayers based on nationality, but based on the status of being or not-being registered with the Tax Authority. This distinguishing criterion is not inextricably linked to the protected criterion, i.e. to nationality, therefore these measures do not result in discrimination based on nationality under tax treaty law.

Although the Constitutional Court deviated from the formal reasoning required by the overly narrow test of direct discrimination under Article 24 and converged its reasoning to that of the CJEU, the outcome of its decision has been different from what the CJEU would likely decide.

Different conclusion under the EU fundamental freedoms?

Unlike the prohibition of discrimination based on nationality under tax treaty law, EU non-discrimination rules also prohibit indirect forms of discrimination. However, the mere fact that a seemingly neutral distinguishing criterion adversely affects non-nationals is not sufficient and there should be a certain correlation between such a criterion and foreign nationality. The case law of the CJEU is inconclusive in this regard.

Most recently, AG Kokott argued in favor of narrowing the scope of indirect discrimination in her Opinion in the *Vodafone* case (C-75/18). She made a distinction between qualitative and quantitative criteria with respect to the extent and character of the correlation between the distinguishing criterion. As regards the quantitative criterion, the correlation must be identifiable in the *vast majority or the cases*. However, the new element in her reasoning is that a purely quantitative approach is not sufficient and therefore, a qualitative criterion must also be taken into consideration: the distinguishing criterion must *intrinsically or typically* affect foreign companies. The purpose of the qualitative criterion is to exclude merely incidental quantitative correlations.”

Another novelty in her reasoning is the intention of the legislature, which, should be taken into account in the examination of indirect discrimination. In particular, even if the distinguishing criterion does not intrinsically correlate with the seat of undertakings, legal relevance should be assigned to the fact that the legislator intentionally chose the distinguishing criterion in order to disadvantage foreign undertakings and this disadvantaging effect is quantitatively measureable.

Even if one applies the higher indirect discrimination standard put forward by AG Kokott, the existence of indirect discrimination is undisputable in this case. Under the rules at issue, the distinguishing criterion is the status of not-being registered for the purposes of any Hungarian tax. Regarding the quantitative criterion of the correlation, it is easy to conclude that the registration requirement applies to non-nationals not only in the vast majority of cases but practically exclusively. Hungarian legal entities are out of the scope of the registration requirement of the Advertisement Tax because they are registered with the Tax Authority as of the time of their incorporation. As far as the qualitative criterion is concerned, there is an intrinsic connection between the status of not-being registered for Hungarian tax purposes and foreign nationality as their relationship is certainly more than incidental. Consequently, the provisions at issue of the Advertisement Tax Act amount to indirect discrimination even under the most rigorous test.

Under CJEU case law, it is possible to investigate the EU law compatibility of a domestic measure consisting of different provisions separately. One can find good examples in the area of exit taxation for the distinct examination of related elements of one set of rules, such as assessing an

exit tax and collecting it immediately at the time of exit. Consequently, the CJEU can test the registration requirement, the corresponding default penalty and legal remedy provisions separately in the light of the fundamental freedoms.

As far as the registration requirement is concerned, one has to identify the comparable domestic situation in order to decide whether a foreign taxpayer is treated less favourably. Comparability must be decided in the light of the objective pursued by the national provision, which is, in the current case, to curb tax avoidance of foreign national taxpayers, who are not registered with the Tax Authority. However, finding the appropriate comparable domestic situation is troublesome. The hypothetical comparable situation would be that of a Hungarian national taxpayer who carries out advertising activity subject to advertisement tax liability without being registered for the purposes of any type of Hungarian tax. This hypothetical Hungarian taxpayer does not exist in practice. Real Hungarian taxpayers are all registered with the Tax Authority and this circumstance makes them incomparable with foreign not-registered taxpayers from the point of view of the anti-tax avoidance aim of the registration obligation. Thus, Hungarian taxpayers and foreign taxpayers are not in an objectively comparable situation from the perspective of the aim pursued by the registration requirement.

Regarding the aim of the default penalty provision, which is to make foreign taxpayers comply with their registration obligation, the anti-avoidance nature persists. However, the distinct test enables the finding of another objectively comparable domestic situation if it is more suitable, instead of mechanically applying the one identified for the purpose of the registration obligation. As Hungarian taxpayers will never be subject to this provision in practice, choosing such a Hungarian taxpayer who did not comply with its registration requirement and is obliged to pay the default penalty as a comparison would be purely hypothetical. The correct comparator is a Hungarian taxpayer who failed to comply with one of its administrative obligations outside the scope of the rules of the Advertisement Tax. In such a case, a default penalty of HUF 500,000 would be imposed on the Hungarian taxpayer. It is 2000 times lower than the maximum amount of default penalty under the Advertisement Tax. It would be very hard to argue that such an extraordinary difference between the amount of the penalty imposed on a foreign company that fails to register for Advertisement Tax purposes and on a domestic company that fails to comply with any other administrative obligation does not constitute a discriminative distinction of objectively comparable situations.

Similar conclusion can be drawn with respect to the procedural rules regarding the legal remedy against the penalty under the Advertisement Tax that are more restrictive than the general rules on legal remedies against administrative decisions.

As regards the justification of the differential treatment, the aim of the default penalty is to enforce compliance and prevent tax avoidance, these being accepted grounds of justification in the CJEU's case law. In case of the rules concerning the legal remedy, the existence of an acceptable justification is more questionable. As the connection between prevention of tax avoidance and procedural rules applicable to legal remedy against the resolution of the Tax Authority is rather remote, it is fair to state that these rules can be justified neither by the public interest of fighting tax avoidance, nor by any other justifications.

Even if a national provision is justified, it must also fulfill the proportionality test. The imposition of a default penalty connected to non-compliance with the registration obligation seems to be appropriate to enforce registration. The second prong of proportionality is the necessity test.

Member States should opt for the least burdensome measures among those appropriate under the first part of the test. In our opinion, the outstandingly high amount of the default penalty and the way of its imposition, i.e., on a daily basis, exponentially increasing to the triple of previously imposed amount, are not necessary to enforce registration.

Conclusion

The analysis under the EU fundamental freedoms leads to a different result than the nationality non-discrimination clause of a DTC in the interpretation of the Hungarian Constitutional Court. In this case, this disparate result is hardly explicable and goes against a common sense of justice, as such a disproportionate differential treatment that strikes only foreign nationals ought to be sanctioned under the non-discrimination clause of tax treaties.

Although the Constitutional Court applied a rather mixed approach, it concluded that no violation of Article 24 (1) of the DTC occurred on the grounds that the registered Hungarian taxpayers are not comparable with the not-registered foreign taxpayers. Under the CJEU non-discrimination test, this outcome might be reached regarding the registration obligation, however, comparability should be analyzed separately with respect to the different procedural rules. Following this approach, the amount and manner of imposition of the default penalty fail the proportionality test, while the rules restricting the scope of available legal remedy cannot be justified. We can only hope that AG Kokott's forthcoming opinion in the Google case confirms our analysis and sets clear limits to the administrative rules aimed at enforcing compliance with new taxes that are being increasingly introduced for taxpayers without physical presence in a jurisdiction.

END NOTES

[1] Due to subsequent amendments, the rate structure has changed several times.

[2] Commission Decision (EU) 2017/329 of 4.11.2016 and GC, 28 June 2019, Case T-20/17, *Hungary v Commission.*

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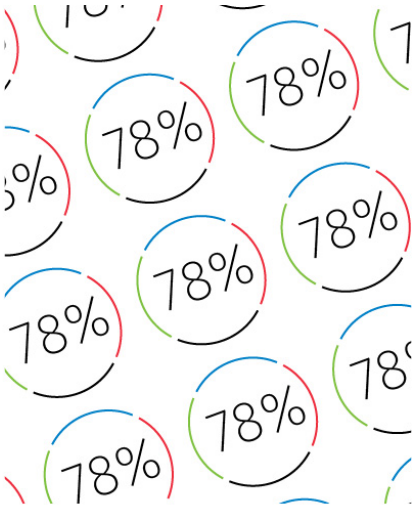

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