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VAT, Industry Levies and Rebate Schemes

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The Novo Nordisk AS ruling (C-248/23), issued by the CJEU on September 12, 2024, is the latest in a string of decisions on the VAT regime of rebate schemes in the pharmaceutical sector. In this ruling the CJEU looks at a new question: whether a tax on the sales of pharmaceutical companies can be qualified as a price reduction for the purposes of VAT. Litigation will resume shortly.

1. **The case**

The Novo Nordisk case concerns a company operating in the Hungarian market.

Novo Nordisk's products are sold by the company to wholesalers and then by wholesalers to pharmacies. When pharmacies sell products to end consumers, different public subsidy schemes may apply. Certain prescription medicines may be subsidized by the Hungarian National Health Insurance Fund (NEAK). In that case, the consumer pays the pharmacy only a part of the price — the "subsidized price" — and NEAK will afterwards transfer to the pharmacy the remainder.

This rebate scheme is not entirely financed by the Hungarian state, however.

Under Hungarian law, pharmaceutical companies are obliged to make a payment amounting to 10 or 20 per cent of the subsidies granted to such products. To this end, companies are obliged to submit a periodical declaration and make the payment to the Hungarian tax authority, which then transfers the funds to NEAK.

The Novo Nordisk case has obvious similarities with the Boehringer cases.[1] Here, too, we are dealing with a rebate which operates after goods have been supplied and which is granted to people other than those who are part to the operation. And here too we have a rebate which results in the company supplying the products not keeping the entire amount resulting from its supply to wholesalers.

The distinctive point of the Novo Nordisk case lies in the fact that this "payment" is mandatory by law and is made for the benefit of a public body, and may therefore be regarded as a tax — as indeed the Hungarian authorities insist it is.

In such cases, where an *ex lege* payment is made to a public body, can it still be said to be a price reduction for the purposes of Article 90 of the VAT Directive?

2. **The AG's take**

In her opinion on the case, Advocate General Tamara Capeta starts by asking the question: "Is such a payment a price reduction, in which case the taxable amount should be reduced for the amount of that payment on the basis of Article 90(1) of the VAT Directive, or is such a payment a discharge of the obligation to pay a special tax, in which case it does not affect the taxable amount?"[2]

The AG's analysis therefore relies on the assumption that Articles 78(a) and 90(1) of the VAT Directive are mutually exclusive — the very same assumption the parties to the case seem to have relied on. A special tax on a transaction cannot for the purposes of VAT simultaneously be part of the transaction's taxable amount and represent a reduction of its price. It is either one thing or the other.

On this assumption, the AG explores the requirements for the application of Article 78(a). According to CJEU case law, for a payment to be covered by this provision, it must constitute a tax and have the same chargeable event as VAT.

As to the chargeable event, the AG simply remarks that "it is undisputed that the delivery of the medicinal products is the chargeable event for the *ex lege* payment and for the VAT".[3] As to what is a tax, things are less straightforward.

There being no clear case law on what a tax for the purposes of Article 78(a) is, the Commission suggests one should consider whether a payment is mandated by law, whether it has a predetermined base and rate, who is its beneficiary and what is the intention of the national legislator and the objectives of the payment.

The AG takes a dim view of these criteria, noting they don't always allow a firm conclusion and certainly not in the case of the payments made by Novo Nordisk. After all, a price reduction can also be mandatory and the law may stipulate its base, amount and beneficiaries. And the legislator's intention is difficult to prove.

In the AG's opinion, the decisive point in qualifying the payments made by Novo Nordisk lies in their predictability. A payment should only be qualified as a tax when it is possible to clearly anticipate that the legislator is demanding it as such. In the case at hand, the Hungarian law referred to the payment as a rebate and pharmaceutical companies could not anticipate it would be demanded as a tax.

It follows that the payments made by Novo Nordisk are not covered by Article 78(a) and should instead be regarded as a price reduction under Article 90(1).

"That, however, does not prevent a Member State to enact, in a more explicit manner, a fiscal measure which would fulfil a similar objective of financing the public health policy."[4]

3. **The ruling**

The CJEU chose a different line of thought.

In its ruling, the court does not refuse to qualify the payments made by Novo Nordisk as a tax.

Subject to verification, the CJEU admits that these payments, being mandated by law, do not represent added value nor can be regarded as part of the economic consideration for the supply of these medicinal products.[5]

The CJEU also admits the chargeable event for these payments "may coincide with the chargeable event for the VAT due on the subsidised medicines" as the obligation stems from the sale of medicines by pharmaceutical companies and the amount is a function of the quantity sold and the amount of public subsidy.

Therefore, such payments may be regarded as a tax that is part of the taxable amount of supplies made by pharmaceutical companies, under Article 78(a).

According to the CJEU, the classification of these payments as a tax for the purposes of Article 78(a) VAT Directive does not preclude treating them as a price reduction for the purposes of Article 90(a), an altogether different matter.

The *purpose* of payments based on a legal mandate may be no different from the purpose of payments based on contracts between the pharmaceutical industry and the state, "namely to subsidise the purchase price of prescription medicines reimbursed by social security in the context of outpatient treatment".[6]

The *results* of legal and contractual payments may also be the same: to oblige companies forgo a fraction of the price they receive from wholesalers.

Whatever the source of the payment obligation, it would be inconsistent with the principle of neutrality to demand from pharmaceutical companies VAT calculated upon an amount which is higher than the amount ultimately received.

The *ex lege* or *ex voluntate* source of a rebate scheme should therefore be considered irrelevant in itself. A special tax on pharmaceutical sales must be treated in the same way as a payment resulting from a contract or agreement.

It is on this basis that the CJEU recognises that the payment to which Novo Nordisk is obliged constitutes a reduction in the price of its sales, and that it should therefore be recognised as entitled to rectify the corresponding VAT.

4. **Not all taxes are created equal**

The CJEU's approach has ovious merits. By equating contractual obligations with *ex lege* obligations, which are used interchangeably in many rebate schemes in the pharmaceutical sector, this approach better guarantees the principle of neutrality. Furthermore, by avoiding a discussion on the concept of tax and on its "predictability", it brings greater certainty to the treatment of these payments.

The court's position on Novo Nordisk AS nevertheless demands a clear answer to two questions: first, which taxes are covered by Article 78(a); second, in which cases exactly do these taxes lead to a price reduction under Article 90(1).

As to the first question, there is abundant case law.

In the *Cooeperatieve Aardappelenbewaarplaats* (C154/80) judgement, the CJEU stated that for the purposes of (current) Article 78 the taxable amount should include everything which makes up the consideration, meaning there must be a direct link between the service provided and the consideration received if the supply of a service is to be taxable.[7] This doctrine was restated in other decisions relating to the contractual elements of the consideration, Such as *Naturally Yours Cosmetics* (230/87), *Empire Stores* (C?33/93), and *Bertelsmann* (C?380/99).[8]

In line with this doctrine, the CJEU has held that in order for taxes to be included in Article 78(a) they must also have a direct link with the supply, meaning their *chargeable event* should coincide with that for VAT. It is from this perspective that the court has analysed the case of various taxes on the sale or registration of cars — *De Danske Bilimportorer* (C?98/05), *Commission vs. Poland* (C-228/09), *Commission vs. Austria* (C?433/09), *Lidl* (C?106/10) — a commercial advertising screening tax imposed on TV stations — TVI (Joined Cases C?618/11, C?637/11, C?659/11) — or municipal land use taxes — *Lisboagás GDL* (C?256/14).[9]

As to the second question, we are in uncharted territory. Once a tax is levied on a transaction, how can it be conceived as a price reduction for the seller?

The Novo Nordisk sheds some light into this question. As far as can be surmised from the case, in particular from the request for a preliminary ruling, the payment pharmaceutical companies are obliged to make legally stems from the sale of subsidised medicinal products and is ultimately based on their production price.[10]

For this reason, both the AG and the CJEU infer this compulsory payment has the same chargeable event as VAT, that is, the obligation that is imposed on pharmaceutical companies is generated by the supply they make to wholesalers.

This point, however, seems to deserve better scrutiny. In fact, a tax whose chargeable event is the turnover of companies can operate in different ways.

A tax can be levied on the value of transactions so as to be passed on to the buyer along with the price, at the moment a transaction takes place. Or it can instead be levied on the value of transactions so as to be borne by the seller, dissociated from the price. In other words, a tax on turnover can be structured either as a direct or indirect tax — and this is even true of taxes on added value.[11]

Many industry levies in the European Union, from the financial sector to telecoms, are calculated upon the turnover of companies and yet they are not intended to be passed on to buyers in the fashion that is typical of consumption taxes. Their chargeable event may “coincide” with that of EU VAT but only to a certain extent: VAT is intrinsically associated with each single transaction while these levies are associated with the aggregate value of transactions for a given period of time.

This may explain the intricacies of the Hungarian compulsory payment, namely the ability to deduct certain (R&D) expenses from the taxable base as well as an assessment mechanism that seems entirely decoupled from the single supplies made by companies. This may also explain why the Hungarian compulsory payment entails a price reduction for pharmaceutical companies: the payment is levied after supplies to wholesalers take place and is not meant — and effectively cannot be — passed on to wholesalers at the moment of supply.

In short, to the extent such compulsory payments are to be qualified as a taxes we should recognise them more as direct than indirect taxes on turnover. Direct taxes on turnover may be taken as price reductions for the purposes of Article 90(1), since they force suppliers to "forgo a fraction of the price" received. And precisely because they are meant to be borne by suppliers, such taxes should not be considered as part of the taxable amount for the purposes of Article 78(a).

Articles 78(a) and 90(1) VAT Directive are indeed mutually exclusive. Either a tax on turnover is of an indirect nature and thus part of the VAT taxable amount or it is a direct tax and may lead to a price reduction. No way out of this squeeze.

[1] CJEU, *Boehringer Ingelheim Pharma*, C-462/16; *Boehringer Ingelheim*, C-717/19.

[2] CJEU, *Novo Nordisk A/S*, C-248/03, Opinion AG Capeta, 6.06.2024, 25

[3] CJEU, *Novo Nordisk A/S*, C-248/03, Opinion AG Capeta, 6.06.2024, 49.

[4] CJEU, *Novo Nordisk A/S*, C-248/03, Opinion AG Capeta, 6.06.2024, 70.

[5] CJEU, *Novo Nordisk A/S*, C-248/03, 12.09.2024, 36-37.

[6] CJEU, *Novo Nordisk A/S*, C-248/03, 12.09.2024, 48.

[7] CJEU, *Staatssecretaris van Financïen v Cooeperatieve Aardappelenbewaarplaats*, 154/80, 5.02.1981.

[8] CJEU, *Naturally Yours Cosmetics*, 230/87, 23.11.1988; *Empire Stores*, C?33/93, 2.06.1994; *Bertelsmann*, C?380/99, 3.07.2001.

[9] CJEU, *De Danske Bilimportorer*, C?98/05; *Commission vs. Poland*, C-228/09, 20.05.2010; *Commission vs. Austria*, C?433/09, 22.12.2010; *Lidl*, C?106/10, 28.07.2011; *Lisboagás GDL*, C?256/14, 11.06.2015; TVI, 618/11, C?637/11 and C?659/11, 5.12.2013.

[10] CJEU, *Novo Nordisk A/S*, C-248/03, Request for a Preliminary Ruling, 18.04.2023, . CJEU, *Novo Nordisk A/S*, C-248/03, 12.09.2024, 38: "it is apparent (…) that the event giving rise to the ex lege obligation on the taxable person (…) is the sale of the medicinal products". CJEU, Novo Nordisk A/S, C-248/03, Opinion AG Capeta, 6.06.2024, 49, "it is undisputed that the delivery of the medicinal products is the chargeable event for the *ex lege* payment and for the VAT".

[11] Alan Schenk/Oliver Oldman, *Value-Added Tax: A Comparative Approach*, Cambridge, 2007, 42-46.

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