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Highlights & Insights on European Taxation

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– ***Novo Nordisk*** **(C-248/23)**. An ex lege obligation for pharmaceutical companies to pay part of the subsidies received can be regarded both as a tax and a reduction of the taxable amount. Court of Justice

(comments by **José Manuel Macarro Osuna**) (*H&I* 2024/317)

The case

Novo Nordisk is a Danish pharmaceutical company that sells medicines in Hungary. In this country, the National Health Agency finances the purchase price of some medications sold on prescription. The subsidized products are sold by the pharmaceutical company to wholesale distributors, which resell them to pharmacies. The pharmacies supply the products to final consumers, who only pay the subsidized price. The National Health Insurance Agency reimburses

the subsidy to the pharmacy, so pharmacies will have to include such an amount in the taxable amount and will pay the VAT on the total price of the medication. In order to have its products included in the portfolio of medicines financed by social security, pharmaceutical companies have to enter into a 'price volume' agreement with the Health Agency, under which they have to make payments to the latter regarding the volume of subsidized products sold. In a previous judgment, the CJ had already stated that the payment under this price-volume agreement must be considered a reduction of the taxable amount of the subsidized products by the pharmaceutical company (CJ 6 October 2021, C-717/19 *Boehringer Ingelheim*, ECLI:EU:C:2021:818, hereinafter *Boehringer Hungary*).

Apart from this agreement, Hungarian legislation had created a legal obligation that would affect pharmaceutical companies whose products are financed by the social security system. This ex lege obligation subjects those companies to pay a fixed percentage (generally 20%) of the subsidies received for the financed products sold to final consumers. From the taxable base of this obligation, pharmaceutical companies are entitled to deduct the amounts due under the price volume agreement and research and development expenses. The legal obligation has to be paid to the Hungarian tax authorities, who subsequently transfer the sum collected to the Health Agency.

After paying the legal obligation and the price volume agreement, Novo Nordisk adjusted its VAT declaration, reducing its taxable amount by both quantities. Although the first-tier authority rejected the adjustment for both payments, the Appeals Directorate referred to the CJ's decision in *Boehringer Ingelheim* (C-717/19), and limited the adjustment to the price volume agreement, refusing the reduction for the legal obligation. According to its reasoning, this legal obligation had to be considered a special tax, as Hungarian legislation establishes that the payments that must be credited to the tax authorities should be treated as taxes. Therefore, it is considered that, as a special tax, it cannot be regarded as a price reduction, and thus, it cannot be used to adjust the taxable amount of the transactions.

Novo Nordisk appealed against this resolution before the Budapest High Court, which referred the matter to the Court of Justice of the European Union (hereinafter: 'CJ'), requesting a preliminary ruling. The referring Court asked whether, according to Article 90(1) of Council Directive 2006/112/EC of 28 November 2006 on the common system of value added tax (hereinafter: 'the VAT Directive'), pharmaceutical companies should be entitled to reduce their taxable amount for the ex lege payment made to the State Health Agency, based on three points: first, the fact that the obligation stems from the law; second, that the base of the legal obligation allows the deduction of the payments made under the price-volume agreement and research and development expenditure; and third, that the payment is collected by the tax authorities, which transfer that amount immediately to the Health Agency.

The judgment of the CJ

The CJ recalled that the answer to this preliminary ruling must follow one of the fundamental principles of the VAT Directive, according to which the taxable amount is the consideration actually received, and the tax collected cannot exceed the tax received by the taxpayer. The first matter addressed by the CJ is whether the payment of this legal obligation must be regarded as a tax within the meaning of Article 78(a) of the VAT Directive and be included in the taxable amount. In its case law, the CJ has repeatedly stated that the taxes and duties that have to be included in the taxable amount for VAT must have a direct link with the supply, regardless of whether they represent any value added or constitute financial consideration for the sale. The judgment establishes that a decisive factor in determining the existence of this direct link is whether the chargeable event of the legal obligation coincides with that of VAT.

The legal payment to the Health Agency is fixed in advance and is mandatory, and its taxable event is the sale of medicinal products. Furthermore, the calculation of the payment correlates with the volume of products sold and the amount of social security subsidy received for those goods delivered. The CJ refused the claim that the deduction of the two payments (price-volume agreement and R&D expenses) from the amount of the legal obligation alters its classification as a tax. Regarding the price volume agreement, the judgment points out that its beneficiary, as in the ex-lege obligation, is always the Health Agency. Concerning the expenses on R&D in the health sector, as the Hungarian Government did not provide details about them, the CJ did not consider them relevant. The judgment concluded that the chargeable event of this obligation may coincide with that of the VAT due for the products sold, and therefore, it can be included in the taxable amount for VAT purposes.

The main doubt that the CJ had to address in this case was whether a payment that is considered a tax under Article 78(a) of the VAT Directive can also be considered a price reduction that can reduce the taxable amount under Article 90(1) of the VAT Directive. In a previous judgment, the CJ had already determined that the obligation established by German law under which a pharmaceutical company whose products are sold to persons covered by private health insurance, which reimburses the price to the patients, had to provide a discount for those private health insurance companies (CJ 20 December 2017, C-462/16 *Boehringer Ingelheim Pharma*, ECLI:EU:C:2021:818, hereinafter *Boehringer Germany*). Contrary to what was alleged by the Hungarian Government, the CJ found that the private nature of the insurance companies in the previous judgment made no difference to its legal reasoning. In the current case, the actual beneficiary of the legal obligation is the Health Agency, not the tax authorities, and the aim of the obligation is the same as in the *Boehringer Germany* case, to subsidize medicines. Thus, the CJ stated that the fact that the payment is made to the tax authority is not relevant, as it transfers the amount collected immediately to the Health Agency. In fact, the judgment concludes that this immediate transfer ‘supports the classification of the disputed payments as a price reduction’.

Furthermore, in the *Boehringer Hungary* judgment, the CJ had determined that the payment under the mentioned price-volume agreement would reduce the taxable amount, as it was not part of the company’s commercial policy nor made for promotional purposes. The judgment highlights that the purpose of the ex-lege obligation and the price-volume agreement was the same: to finance the

social security system that subsidizes the price of medicinal products. The CJ stated that, even though the direct beneficiaries of the goods are the patients, and considering that the pharmacies must pay VAT on the subsidized price plus the subsidy, the State Health Insurance Agency must be regarded as the final consumer of the supply made by a pharmaceutical company, and the amount payable to the tax authority must not exceed that paid by the final consumer.

Therefore, the conclusion of the judgment is that the taxes or duties that Member States can levy under Article 401 of the VAT Directive can be used for the calculation of the taxable amount, according to Article 78(a) of the VAT Directive, as a price reduction within the meaning of Article 90(1) of the VAT Directive. In the current case, the CJ stated that the taxable person is waiving a proportion of the consideration paid by the wholesaler and that part of the consideration would not be considered received because of the payment to the State Health Insurance Agency. Thus, Novo Nordisk was 'not able to freely dispose of the full amount of the price', so the payment of the legal obligation had to be considered as a reduction of the price applicable after the supply had taken place.

Discussion: A legal obligation with a special link to the price, considered a tax for VAT purposes and a price reduction

Novo Nordisk (C-248/23) offers some complex legal reasoning regarding the functioning of VAT when other legal obligations are involved. This is the third judgment that delves into the calculation of the taxable amount in the pharmaceutical sector in relation to different payments that must be made by companies whose products are bought by users who benefit from a subsidized price. The VAT Directive establishes that the taxable amount includes 'subsidies directly linked to the price of the supply' (Article 73 of the VAT Directive) and 'taxes, duties, levies and charges' (Article 78(a) of the VAT Directive). The CJ has established the mentioned requirements to determine whether the special tax has a direct link with the supply and, if so, should be included in the taxable amount of a transaction. In this case, the judgment states that the chargeable event is similar to that of VAT, i.e., the sale of goods, and that its taxable base corresponds to part of the price, more specifically, the subsidy granted for the products.

Nevertheless, the most important part of this ruling concerns the consideration of the payment of this obligation as a price reduction that can decrease the taxable amount. Even though AG Capeta was of the opinion (Opinion of AG Capeta, 6 June 2024, C-248/23 *Novo Nordisk*, ECLI:EU:C:2024:464) that the classification of the legal obligation as a special tax would prevent the application of Article 90(1) of the VAT Directive, the CJ decided differently and refused this Opinion. The main conclusion of this judgment is that the payment of special taxes and duties that Member States can levy according to Article 401 of the VAT Directive can be taken into account when determining the taxable amount of a transaction as a price reduction. Nevertheless, the specific circumstances of the case make it uncertain whether this legal reasoning can be generalized to other cases.

According to the reasoning provided by the CJ, the immediate transfer of the amounts collected by the tax authorities supports the consideration of this tax as a price reduction, as it makes it very clear that this obligation aims to directly finance the Hungarian State Health Insurance Agency. However, the CJ does not take into consideration other functions performed by the Health Insurance Agency, as pointed out by AG Capeta, and assumes that the entire ex-lege obligation is destined to finance the subsidies for medicinal products.

Therefore, the specific objective of this payment and its link with the State Agency, which can be considered as the final consumer for subsidizing the product, is decisive in its consideration as a price reduction. The other aspect that supports the application of Article 90(1) of the VAT Directive to this payment is the link between the legal obligation and the price received by the taxable person. Part of the consideration received by the pharmaceutical companies whose products are financed is conditioned to the payment of the legal obligation. This is the situation that makes the CJ state that the taxpayer does not receive the full price as consideration, allowing the reduction of the taxable amount due to the legal obligation. The taxable person initially received the full amount from the wholesaler, but cannot freely dispose of the entire sum, as a proportion of the subsidy must be paid, indirectly, to the State Agency that finances such subsidies. Finally, it is important to point out that the VAT Committee has already been questioned by Lithuania regarding the application of the *Boehringer Ingelheim* cases in cross-border situations, when the pharmaceutical company is not established in the State in which the products are sold and the wholesaler makes an intra-EU acquisition (WP n° 1053 presented to the VAT Committee, Application of VAT on medicinal products sold by pharmaceutical companies, 2022). Although this question has not yet been addressed, it would seem logical that the criteria proposed by the VAT Committee included the payment of legal obligations such as the one assessed by the CJ in *Novo Nordisk* (C-248/23) at comment.

Prof. José Manuel Macarro Osuna

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