

OCTOBER 2020

ECJ considered the Polish bad debt relief regulations non-compatible with the VAT Directive

- On 15 October 2020, the European Court of Justice (“**ECJ**” or “**Court**”) passed a judgment in case C-335/19 E. Sp. z o.o. Sp. k. vs the Minister of Finance concerning compatibility of the Polish bad debt relief regulations with Directive 2006/112/EC (“**Directive**”).

In the judgment, the ECJ held that the **Polish regulations** (Art. 89a(2)(1)-(3) of the VAT Act) **which condition the right to reduce the taxable amount on the requirement that:**

- on the day of delivery of goods or provision of services, and on the day preceding submission of the adjusted tax return aimed at benefitting from the bad debt relief, the debtor must be registered as a VAT payer and must not be subject to insolvency or liquidation proceedings, and
- the creditor must still be registered as a VAT payer on the day preceding submission of the adjusted tax return

are not compatible with Art. 90 of the Directive

Facts

The case involved E. (hereinafter: “**Company**”), which provided the services of tax advice, primarily to VAT taxable persons. The Company issued an invoice including VAT to one of its counterparties for the services it provided, taxable in Poland, calculated according to the basic rate. At the moment of performance of the service, the Company’s

counterparty was registered as an active VAT payer and was not subject to insolvency or liquidation proceedings. Subsequently, during the period of 150 days after the payment date, the counterparty was put into liquidation, but remained registered as a VAT payer.

Since the invoice was neither paid nor sold in any form before the end of two years from its issuance, the Company, wanting to benefit from the bad debt relief, applied for an individual tax ruling. In the application, the Company requested clarification whether it could reduce the taxable amount and the output VAT on provision of the services to the counterparty despite the counterparty being put to liquidation after the services had been performed.

In the individual tax ruling, the Minister of Finance refused the right to benefit from the bad debt relief. To support its position, the Minister referred to Art. 90 of the Directive which provides that a taxable person has a right to reduce the taxable amount only under conditions which shall be determined by the Member States. The Polish regulations conditioned this right, without limitation, on:

- registration of the creditor and the debtor as active VAT payers as at the day preceding submission of the tax return in which the adjustment is made, and of the debtor - also on the date of supply of the goods/provision of services,
- the debtor, on the day of making the performance and the date preceding submission of the return in which the adjustment is made, not being in the course of restructuring or liquidation.

The Company complained against the ruling and, after an adverse decision in this respect, filed a cassation complaint.

Eventually, the Supreme Administrative Court suspended the proceedings and applied to the ECJ for a preliminary ruling, asking the following questions:

“Whether the provisions of Directive 2006/112 – in particular Art. 90(2) of the Directive – allow for the national law to restrict the possibility of reducing the taxable amount in a situation of partial or total non-payment because of a specific tax status of the debtor and the creditor, taking into account the principles of tax neutrality and proportionality.

In particular, whether the EU law does not prohibit a regulation of the national law which provides that a “bad debt relief” can be used on condition that, on the date of performance of a service/supply of goods and on the day preceding submission of the tax return adjusted to benefit from the relief:

- the debtor is not subject to insolvency or liquidation,
- the debtor and the creditor are registered as active VAT payers”

Judgement

In the case at hand, the ECJ reminded that Article 90(1) of the Directive expressed the fundamental principle whereby the taxable amount consisted of mutual performance actually received, and consequently tax authorities may not collect an amount of VAT higher than that received by the taxable person.

The Court further pointed out to the body of rulings which indicates that **national regulations intended to prevent tax frauds and tax evasion may establish deviations from this principle only to the extent strictly necessary to accomplish this special purpose** and may not be used in any way which would

undermine VAT neutrality.

In particular, as regards adjustment of the taxable amount, the formal requirements set for taxpayers should be restrained to proving that, after conclusion of the transaction, partial or total payment of the remuneration will not eventually be received. The ECJ also emphasized that **the Member States may not entirely exclude the taxable persons’ right to reduce the taxable amount in case of non-payment**, and deviations in this respect, if any, should be justified by the need to take into account the uncertainty regarding the final nature of the non-payment.

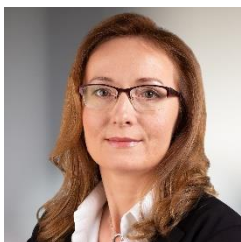
Given the foregoing, the ECJ pointed out that **the conditions set out in the Polish VAT Act are not justified by the need to take into account the uncertainty regarding the final nature of non-payment**, because:

- the fact that the debtor is not registered as an active VAT payer on the date of making the performance and on the date preceding submission of the adjusted tax return is not the reason, *per se*, **to consider that the debt will not be recovered**. The more so that services taxable with VAT may also be made to persons who are not VAT payers (e.g. consumers) and the fact does not affect the obligation to pay VAT by the supplier of goods or provider of services. Moreover, the ECJ held that the obligation for the debtor to reduce input VAT in case of an adjustment does not depend on the debtor’s status as an active VAT payer.
- the fact that the creditor is a VAT payer on the day preceding submission of the adjusted tax **return is insufficient in itself to conclude that the debt may not be recovered** and the creditor’s right to adjust the taxable amount does not depend on retaining its status as an active VAT payer.
- the fact that the Polish regulations provide for the criterion of time after which a debt is considered uncollectible, and require that the taxable amount be increased again if the debt is paid or sold, is not sufficient to comply with the principle of proportionality, and adding the condition that the debtor should not be subject to insolvency or liquidation proceedings may lead to a disadvantageous situation regarding financial liquidity with respect to competitive enterprises from other Member States.

The judgment in case C-335/19 is another favourable judgment issued by ECJ regarding the bad debt relief after e.g. the judgment concerning conditioning the reduction on the debtor's status as a VAT payer in the Czech law (C-127/18 A-Pack), or the judgment concerning conditioning the right to reduce the taxable amount on ineffective insolvency proceedings (C-246/16 Enzo Di Maura).

The favourable ECJ's judgment opens the way for taxable persons to filing requests for a refund of overpaid tax, and, in our opinion, gives them the green light to reduce the taxable amount according to the rules which follow directly therefrom, but until the Polish regulations have been formally amended, such reduction may be contested by the tax authorities.

Should you have any questions or doubts regarding the issues discussed here, we are ready to help you. Feel free to contact us



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