

## ECJ allows proportional VAT fines

*Earlier this week, the European Court of Justice (ECJ C-418/22, Cezam) rendered its decision on the conformity of proportional (percentage-based) fines in Belgium with the tenets of EU law today.*

*The case investigated whether proportional fines for underpaid VAT might be assessed without requiring tax authorities to take deductible VAT into account. A short overview of the verdict is provided hereafter.*

### Facts

The case involves a taxpayer who, over an extended period of time, neglected to file periodic VAT returns in Belgium. Without taking into account deductible VAT, the Belgian Administration assessed fines proportionate to the amount of unpaid VAT. According to the applicable Belgian VAT law, the penalties were calculated as 20% of the turnover.

The taxpayer challenges these fines, citing the fundamental principles of EU law. In order to account for deductible VAT within the relevant time period, it is argued that the penalties should only be calculated on the net amount of the tax. The taxpayer bases this argument on the judgements *Salomie* and *Oltean* (C-183/14 of 09/07/2023) and *EN.SA* (C-712/17 of 08/05/2019), and specifically contends that the principle of proportionality forbids EU Member States from imposing fines on the deductible VAT.

### Preliminary question

The Belgian court asked the European Court of Justice (hereinafter: 'ECJ') for advice on whether the proportional fines system in Belgium adheres to the fundamentals of EU law. The ECJ specifically questioned whether applicable EU regulations, combined with the proportionality and neutrality principles, forbid a system that assesses fines based on the gross VAT amount, without taking input VAT deduction into account.

### Decision of the ECJ

The ECJ starts off by emphasizing that EU Member States must put in place the necessary safeguards to secure the collection of overdue VAT and to prevent fraud. The Member States may decide (within its jurisdiction) what fines to impose, but they must follow Union law and general principles, particularly the principles of fiscal neutrality and proportionality.

Penalties should not be increased above what is required to meet the objectives of tax collection and fraud prevention, according to the proportionality principle. The type and seriousness of the violation, as well as the process used to calculate the punishment amount, must all be taken into account when assessing whether a penalty is proportionate. The ECJ indicates that the infractions for which CEZAM is being punished were both persistent and

purposeful, albeit it is up to the referring court to determine whether the fines in this case are fair. In fact, despite numerous attempts by the Belgian Administration, CEZAM consistently failed to disclose or pay the required VAT over a lengthy period of time. The ECJ states that the CEZAM case is not comparable to earlier ECJ decisions, given that the exact facts and infractions in this instance are different from those in past rulings. Hence the same principle and rules do not hold true and are not applicable.

Regarding the fiscal neutrality principle, the ECJ claims that this principle necessitates the deduction of input tax if the substantive requirements are fulfilled, even if formal requirements have not been met. Notwithstanding this, the case file at hand however does not indicate of how the national legislation or the sanctions in this instance affect the ability to deduct input tax.

The Court finds no evidence to support the taxpayer's inability to rely on this entitlement and concludes that Article 273 of Directive 2006/112 and the principles of proportionality and fiscal neutrality do not conflict with a national regulation that sanctions non-compliance with the duty to submit and pay VAT with a flat-rate fine equal to 20% of the VAT amount that would have been due before deducting deductible VAT. The referring Belgian court must still confirm the fairness of the penalty levied, though.

### Comments

The Member States have the right to impose fines in the absence of harmonization of EU law regarding penalty practices. Nevertheless, Member States must execute their authority in accordance with EU legislation despite the lack of uniformity. As a result, their flexibility is constrained, yet this decision shows that Member States still have a lot of latitude.

The duty to remit VAT and the right to deduct VAT are typically handled differently by tax authorities. The deduction is considered as a right that may only be exercised if the relevant circumstances are met, whereas the remittance is seen as an obligation. Based on the CEZAM decision, it can be concluded that proportional penalties can be imposed in cases of underpaid VAT without considering deductible VAT.

It is crucial to keep in mind that the ECJ affirmed the rule that fines should not be imposed in excess of what is required to guarantee proper VAT collection. The seriousness of the offense should be considered while deciding on the punishment. The question of whether the customary policy of enforcing 20% penalties is justified arises, particularly when there is no risk of a loss of VAT revenue (as in the case of reverse charge). However, this instance is a useful reminder that penalties for failing to comply with VAT regulations can be severe, especially when expressed as a percentage of the transaction. Every company transaction, whether a buy or a sale, contains a potential risk related to the VAT, and if penalties are proportional (i.e., based on a percentage of the transaction), the amounts can add up quickly.



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