

Tax Alert

EU infringement procedure
regarding deductibility of VAT
recharged on open-end lease of
passenger cars



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This issue of our Newsletter looks at the European Commission's formal request that Hungary amend the VAT rules relating to open-end leases of passenger cars.

According to a press release issued by the European Commission on 16 June 2011, Hungary was officially called upon to amend provisions in the VAT Act that disallow a deduction of VAT charged by a lessor on an open-end lease of a passenger car. According to the Commission, the Hungarian rule violates EU law. If Hungary fails to respond within two months, the case will be referred to the European Court of Justice (ECJ).

Legislative background

According to the European Commission, the restriction on the VAT deduction is incompatible with EU law because it was introduced *after* Hungary became an EU member state in May 2004. Member states are permitted to restrict VAT deductions only if the restriction was in effect at the time a country acceded to the EU; any restriction introduced after accession is contrary to EU law.

The disallowance of a deduction was adopted in Hungary on 1 January 2008; as from that date, the VAT Act abolished the right to a VAT deduction on rentals and leases of passenger cars (open-end/operative leases), but on the same date, taxpayers became entitled to deduct VAT on the purchase of passenger cars that were predominantly purchased for a subsequent rental or lease (open-end/operating lease). Thus, the rule introduced on 1 January 2008 created new restrictions on the tax deduction (regarding passenger cars under rentals or open-end/operative leases), but also provided new tax deduction rights (with respect to the purchase of passenger cars to be later rented out or leased out under an open-end/operating lease by the taxpayer).

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Practical implications

If the case is referred to the ECJ, lengthy legal proceedings will follow. Based on other infringement procedures against Hungary thus far, a final decision is not expected in the near future.

It should be noted that even though the infringement procedure now affects the open-end lease of passenger cars, an ECJ decision would also be applicable to operating leases and rentals of passenger cars as these

transactions are not treated differently for VAT purposes. The infringement procedure primarily affects taxpayers who rent or lease passenger cars under open-end or operating lease arrangements for their business activities and who are not entitled to deduct the related precharged VAT under the current rules even though other criteria for a tax deduction are met.

If the procedure continues, the question arises how it will affect provisions of the Hungarian VAT Act (also effective from 1 January 2008) that grant deduction rights to taxpayers for precharged VAT on passenger cars purchased with the purpose of subsequently renting or leasing the vehicle (under an open-end or operating lease).

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