

Indirect Tax | VAT

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***Novo Nordisk* : AG ECJ advises to consider *ex lege* payment obligations as a price reduction rather than a special tax**

On June 6, 2024, Advocate General (AG) Ćapeta delivered an opinion in the case of Novo Nordisk (C-248/23). This opinion follows a preliminary question from Hungary seeking clarification on whether certain payments imposed by Hungarian legislation, calculated based on the price of subsidized medicines, should be treated for VAT purposes as a price reduction or as a tax. The AG believes that it constitutes a price reduction, and that the interested party has the right to a retrospective reduction of the taxable amount. It remains to be seen whether the Court of Justice of the European Union ("ECJ") will follow the conclusion of AG Ćapeta.

Background

Novo Nordisk A/S, a company based in Denmark, is engaged in the manufacturing and distribution of pharmaceutical products. As part of its activities, it sells the pharmaceutical products it manufactures to the Hungarian market.

In Hungary, a portion of the purchase price of delivered medicines can be subsidized by the NEAK, the Hungarian National Health Insurance Fund Management Agency. The NEAK decides whether a medicine should be included on the list of subsidized medicines funded by social security after an examination considering various aspects, and then determines the amount of the subsidy. A patient purchasing a medicine pays an amount at the pharmacy, the 'subsidised price', which corresponds to the difference between the price of the medicine and the amount of the NEAK subsidy. The NEAK reimburses the subsidy amount to the pharmacy afterwards. Therefore, the purchase price for a medicine, which constitutes the taxable amount for VAT, consists of two parts: the subsidy from the NEAK and the 'subsidised price' paid by the patient. The pharmacy accounts for the VAT due regarding the amount paid by the patient and the amount paid by the NEAK.

Novo Nordisk has made payments to the NEAK based on two agreements depending on the sales volume of the medicines and also pays an additional contribution of 20% or 10% over the subsidy of all its sold medicines under an *ex lege* payment obligation.

The referring judge agrees with Novo Nordisk that these additional contributions qualify as retrospective price reductions within the meaning of Article 90(1) of the VAT Directive, thus entitling it to a retrospective reduction of the taxable amount. According to the Hungarian tax authority, Novo Nordisk does not have the right to reduce the taxable amount retrospectively because the legal payment obligation is not a price reduction but a special tax.

Question referred

In the context of this procedure, the Hungarian court has asked the ECJ whether (freely translated) Article 90(1) of the EU VAT Directive should be interpreted to mean that a pharmaceutical company has the right to retrospectively reduce the VAT taxable amount for *ex lege* payments to the State health insurance agency, where the basis for these payments can be reduced with payments under other agreements and various expenses of the company, and the amounts due are collected by the State tax authority, which immediately transfers it to the State health insurance agency?

Opinion AG Ćapeta

In her opinion, AG Ćapeta notes that previous case law from the ECJ in the cases of Boehringer Germany (C-462/16) and Boehringer Hungary (C-717/19) provides indications but does not offer a definitive answer. According to the AG, Novo Nordisk was required to pay NEAK an amount directly connected to the quantity and price of the product supplied, the payment and performance of which occurred after the supply of those products. From the case Boehringer Germany, it follows that a price reduction does not need to be voluntary but can also result from a legal obligation. Moreover, the AG considers that NEAK, like the insurance company in Boehringer Germany, can be seen as the final consumer of the supplies because NEAK pays part of the price of the supplied medical products. On these grounds, she considers that the *ex lege* payment obligation may constitute a price reduction for the supplied medical products.

As a next step, the AG examines whether the payment to NEAK can be seen as a legally imposed tax, which would leave no room for the reduction of the taxable amount retrospectively. Unlike the insurance company in Boehringer Germany, according to the Hungarian government, NEAK also has a public task which means the payment can be considered as a contribution to the part of the state budget that NEAK is responsible for, which can also be used for other public purposes related to the organization of the Hungarian health system.

The AG believes that the *ex lege* payment obligation does not have the character of VAT since the amounts due are not collected at every stage of the production and distribution process, but are paid only once. To reach her judgment on whether the legal payment qualifies as another type of tax, the AG takes into account the following criteria proposed by the European Commission: (i) whether the payment is compulsory and results from the law, (ii) whether the tax base and rate are predetermined, (iii) the identification of the beneficiary of the payment, (iv) what the national legislator's intention and the objectives of the tax itself were. After examining these criteria, the AG finds these characteristics to be insufficiently met.

Regarding the third criterion, the beneficiary of the payment, the AG notes that although the payment is made to the central budget, it is established that it is immediately and automatically transferred to the part of the budget managed by NEAK. Additionally, the AG particularly doubts the last criterion. Although the Hungarian government argued before the Court that it intended to introduce a tax, according to the AG, this is insufficient because it is also necessary that such

intention is understood by the taxpayers. She therefore falls back on a criterion derived from a ruling by the European Court of Human Rights: the foreseeability by a taxpayer of the intention of a legislature than an *ex lege* payment is imposed as tax. In this regard, the AG judges, subject to verification by the referring court, that the Hungarian legislation has not clearly revealed the possibly intended fiscal nature of the *ex lege* payment. The provisions of the Hungarian legislation do not name the payment as a tax but as 'an obligation to pay'. The explanatory memorandum to the legal provisions characterize the payment as a discount, rather than a tax, as noted by Novo Nordisk and the referring judge.

AG apeta concludes that based on this outcome, the Hungarian regulation is not sufficiently clear, precise, and foreseeable for taxpayers to understand that the *ex lege* payment obligation is a tax and cannot be treated as a price reduction. She therefore advises the ECJ to consider the *ex lege* payment obligation as a price reduction and not as a special tax.

Practical impact

For pharmaceutical companies that have payment obligations to public health insurers or similar institutions, this conclusion has a positive effect. The outcome as a retrospective reduction of the taxable base often leads to a VAT refund to the taxpayer. The AG's opinion thus confirms a fundamental principle of the VAT Directive that the taxable amount is the consideration actually received and the corollary of which is that the tax authorities may not collect an amount of VAT exceeding the tax which the taxable person received.

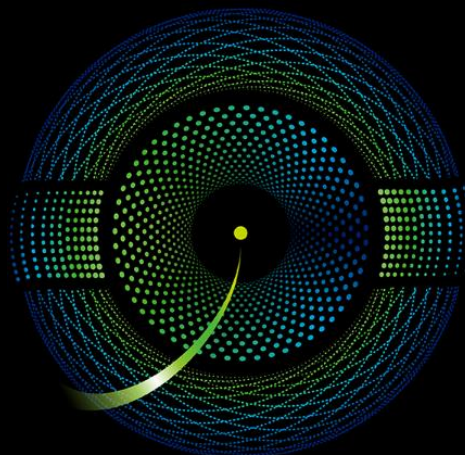
Nevertheless, it remains to be seen whether the ECJ will follow the advice of AG apeta. In her final consideration, the AG also seems to suggest that a ruling in line with this conclusion could prompt tax authorities to design their laws and regulations more explicitly to be able to treat such payment obligations as taxes in the future. Whether this is to be expected is highly questionable. The regulations and interests are complex, and any potential adjustment is very dependent on the dynamics in the respective member state.

In practice, we see many forms of 'rebate schemes', which can vary from country to country and may or may not be based on a legal provision or prevailing regulation. We advise pharmaceutical companies to map out and evaluate their pricing agreements, payment obligations, and compensation schemes in various countries to determine the extent of their right to reduce the taxable amount and other possible consequences that might arise from the outcome of this procedure.

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