



## Powder keg VAT group: ECJ decides on a billion-euro budget gap

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### 1 Problem

Again and again the ECJ has handed down judgments that have had a considerable impact on the German budget. The so-called "Seeling" case law led to a billion-euro gap at the beginning of 2000. A few years ago, many property developers also took in profits as a result of an ECJ decision. In both cases, the legislator reacted retrospectively and passed legal amendments. Now, in its decision of 11.12.2019 (Ref. BFH XI R 16/18), the Federal Fiscal Court has referred a case to the ECJ that overshadows all previous cases. The case is likely to impact VAT revenue in excess of EUR 20 billion p.a.

### 2 Background

For years now, a dispute has been smoldering over the conditions, which apply to a VAT group. Among the tax courts there is no consensus as to how the ECJ case law in *Larentia + Minerva* (C-109/14) is to be understood. Each court claims its own sovereignty of interpretation. Only recently, the Tax Court of Berlin-Brandenburg (decision of 21.11.2019, 5 K 5044/19) again referred the question to the ECJ as regards the conditions under which partnerships can be regarded as controlled companies. Some of you might have wondered whether this referral to the ECJ was really "necessary". In the interests of all parties involved, it would certainly have been better to resolve this dispute nationally. After all, we often get more "stones than bread" from the ECJ. In addition, these stones always apply only to the individual case presented. With the new reference for a preliminary ruling, however, the Federal Fiscal Court now overshadows everything else.

### 3 Facts

In the main proceedings, the Tax Court of Schleswig-Holstein (decision of 06.02.2018, 4 K 35/17) held that a VAT Group existed between a limited liability company (GmbH), as a controlled company, and A as the controlling company. The



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latter held 51% of the shares in the GmbH, while C held the remaining 49%. Due to a special provision in the articles of partnership, A did not have a majority of voting rights, despite its status as majority shareholder. Nevertheless, the Tax Court assumed that the majority shareholding alone allowed A to be designated as the controlling company with legal certainty, since C, as a minority shareholder, was excluded from the position of controlling company.

#### **4 Federal Fiscal Court asks crucial question**

The Federal Fiscal Court could have decided the case using its national tools. However, it has now asked the ECJ the crucial question: it wants to know whether the previous German understanding, according to which the controlling company (and not the VAT group itself) is the taxable person and thus the tax debtor, is in principle, compatible with Union law. The Federal Fiscal Court has also asked the ECJ whether (if the first question is answered in the negative) an individual can invoke Union law (which is contrary to German VAT law in this respect).

The ECJ must thus make a fundamental decision on the continued validity of the (previous) German legal institution of the VAT group. The ECJ decision may result in all previous VAT returns of controlling companies being deemed incorrect. Requests for correction would be possible within the limitation period. Controlling companies themselves would rejoice. However, the state would be confronted with dramatically high back taxes. It is highly questionable whether the state would ultimately be able to indemnify itself against the controlled companies. It would have to assess the VAT against the VAT group, in its entirety. However, a VAT group does not have any legal personality. The other questions referred by the Federal Fiscal Court are also very interesting. For example, the Federal Fiscal Court also referred the question to the ECJ of whether the national requirement for financial integration should be interpreted strictly or rather generously. Finally, the fourth question referred to the ECJ is particularly relevant for corporate groups: To what extent must the controlling company be in a position to enforce its will against the controlled company? This calls into question the German view of the tax authorities, which, in principle, consider it necessary for the management bodies to be identical.

#### **5 Consequences for the practice**

The XI<sup>th</sup> Senate of the Federal Fiscal Court has raised the crucial question. It is now for to the ECJ to give its verdict. Perhaps it is also a cry for help from the XI<sup>th</sup> Senate to the German legislature. Reading between the lines, it is very clear that the XI<sup>th</sup> Senate is in favour of group taxation. The V<sup>th</sup> Senate of the Federal Fiscal Court probably rejects this, which the XI<sup>th</sup> Senate also points out in its reference for a preliminary ruling. In its decision on the community of part owners (decision of 22.11.2018, V R 65/17), the V<sup>th</sup> Senate decidedly opposed the VAT liability of the legally incapacitated community of part owners. Thus, the V<sup>th</sup> Senate also indirectly rejected the implementation of group taxation. The XI<sup>th</sup> Senate views the situation differently and now wants to obtain support for its view from the ECJ. This will inevitably bring movement back into the national discussion on the future of the VAT group. The federal and state governments have probably been working for some time on the alternative introduction of group taxation, whereby different companies can form a group, upon application. The “drop of bitterness” would be the associated joint and several liability of the group (see KMLZ Newsletter 37/2019).

The German legislator must now do its homework as quickly as possible. A legislative procedure should be started quickly on the implementation of group taxation in conformity with EU law. Legislators will also have to ask themselves how they will be able to avoid the imminent budget deficit. This again makes a legislative initiative from North Rhine Westphalia (BR-Drs. 310/18), demanding legal linking rules for VAT in order to exclude system-related “windfall profits” in VAT, highly interesting.