KÜFFNER MAUNZ LANGER ZUGMAIER

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KMLZ VAT NEWSLETTER

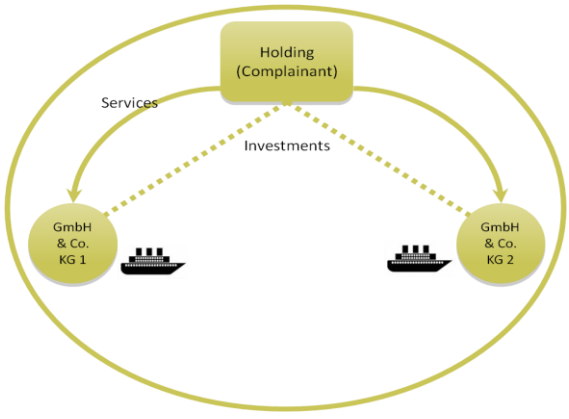
ECJ turns VAT group upside down

1. Problem

According to sec. 2 para. 2 no. 2 German VAT Act, only legal persons may function as controlled companies. It is also required that the controlled company is subordinated to the controlling company in financial, economic and organizational terms. However the Union law is not as restrictive. According to Art. 11 para. 1 VAT Directive, Union law provides that *persons who are connected closely* in financial, economic and organizational terms, may set up a VAT group. It is not difficult to see that the national law's wording does not correspond with the wording of the Union law. The ECJ had the opportunity to comment on the previous national understanding regarding VAT groups. This decision was eagerly awaited, as many hoped the ECJ would put an end to the increasingly restrictive case law of the Federal Fiscal Court regarding VAT groups. Furthermore, the ECJ dealt with the issue of VAT deduction regarding holding companies in this particular decision (see upcoming KMLZ Newsletter for more information).

2. Facts

The complainant was a holding company that invested in ship GmbH & Co. KGs. The complainants rendered services to the KGs. The Federal Fiscal Court asked the ECJ if the regulation of sec. 2 para. 2 no. 2 German VAT Act was against Union law, as only legal persons and not private companies may function as VAT groups. Furthermore, a dominant/subordinate relationship was required to exist between the controlling company and the controlled company. The Federal Fiscal Court also wanted to clarify whether a taxable person may directly refer to Union law.



Expansion of the VAT group

According to German law, only legal persons may function as controlled companies. It is also required that the controlled company is subordinate to the controlling company in financial, economic and organizational terms. Now, the ECJ has turned the previous understanding upside down: National law does not correspond with Union law. Furthermore, the previous understanding of the existence of a VAT group by the Federal Fiscal Court was too restrictive. The most important question now is: How can entrepreneurs benefit from this new interpretation of the law?

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3. ECJ judgment of 16 July 2015 (C-108/14, C-109/14 *Larentia + Minerva)*

The ECJ found that Union law leaves almost no room for Member States to exclude private companies, such as the GmbH & Co. KG, from VAT groups. The exclusion may, at best, only be justified in order to prevent tax fraud – see Art. 11 para. 2 VAT Directive. However, it remains to be examined by the national law, namely the Federal Fiscal Court, whether the exclusion of private companies does in fact prevent tax fraud.

The ECJ has similar procedures for examining the necessity of subordination: Subordination may suggest a close connection between VAT group and the controlling company. However, there are other characteristics that may also suggest a close connection. Yet, every Member State has the right to restrict this characteristic in order to prevent tax fraud. National law also has to examine whether these restrictions are necessary and appropriate.

Finally, the ECJ's answer with respect to whether a taxable person may refer to Union law directly was: As the regulation in the VAT Directive was not absolute with regards to content and not sufficiently accurate, it was found that the taxable person may not refer to Union law directly.

4. Practical tips

Are there any benefits at all for entrepreneurs? This can be answered with an unequivocal "YES". Over the past years, the Federal Fiscal Court has imposed ever increasing requirements regarding VAT groups. For instance, the financial integration of sister companies has been denied. The Federal Fiscal Court has also fundamentally complicated the organizational integration for third-party managers. This case law is now to be seen in a new light, as subordination can now only be justified with the argument that it is necessary to prevent tax fraud. It is sufficient if there is a close connection. Furthermore, the Federal Fiscal Court will have to accept private companies as VAT groups, as the general exclusion of private companies cannot be justified on the basis that it prevents tax fraud.

Even if entrepreneurs may not refer to Union law directly, they can at least demand an interpretation by the tax authorities that is in line with Union law. There is nothing in the German law which prevents the parties seeking such an interpretation. The advocate general found, in its opinion in point 116, that the integration of "capitalistically structured" private companies, such as limited partnerships, would not lead to the interpretation *contra legem*.

This decision means that a new chapter regarding VAT groups will now be written. Therefore, all cases shall be kept open. The new ECJ case law will lead to change. Private companies now have hope that it is also possible that a VAT group might be assumed even if there is only a close connection. This might lead to a revisitation of "the good old times" where the following rule applied: If a characteristic is more pronounced, it is sufficient if the other characteristics are less evident.