KÜFFNER MAUNZ LANGER ZUGMAIER

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KMLZ VAT NEWSLETTER

Update regarding VAT groups

1. Throwback: The amended case law by the Federal Fiscal Court

According to the wording of sec. 2 para. 2 no. 2 German VAT Act, partnerships may not be controlled companies in a VAT group. The ECJ has declared this to be contrary, in principle, to European law (legal case C-108/14, *Larentia + Minerva)*. The V. Senate of the Federal Fiscal Court (V R 25/13) has explicitly amended its previous case law in this regard. The V. Senate decided that partnerships may also be controlled companies. This will be the case provided that a partnership's shareholders are persons who are financially integrated into the company of the controlling company within the meaning of sec. 2 para. 2 no. 2 German VAT Act.

The XI. Senate of the Federal Fiscal Court has decided, in a similar but not identical way, regarding this issue (XI R 38/12). The complainant, a public limited company, held more than 99% of the relevant GmbH & Co. KG. However, there were also further minority interests being held. The XI. Senate assumes that partnerships, in the legal form of a GmbH & Co. KG, may be controlled companies. Compared to the V. Senate's judgment, the XI. Senate only saw a small derogation in the justifications but not in the results. The XI. Senate affirmed this in a judgment passed on 1 June 2016 (XI R 17/11).

Various questions have arisen for the practice from these judgments:

- May a GmbH & Co. KG be a controlled company if shares amounting to 80% are held by its limited partner? According to the case law of the V. Senate this would not be possible. However, according to the case law of the XI. Senate, it would actually be possible.

- May a general partnership be a controlled company when it consists of a limited partnership and a natural person, who is the sole shareholder of the limited partnership? According to the case law of the V. Senate this would be possible. However, the XI. Senate has left this question open. May the VAT group refer to the new legal case for past periods?

Upper Tax Authority Frankfurt/Main: A limited partnership (in the following: GmbH & Co. KG) may potentially be a controlled company

The Federal Fiscal Court has recently amended its case law regarding VAT groups and has decided that a partnership may be a controlled company. The heads of unit regarding VAT have discussed the judgments and the results have now been published by the Upper Tax Authority Frankfurt/Main. Fundamentally, the decisions are unlikely to be generally applicable. Right now, the tax authorities only recognize a GmbH & Co. KG, which is completely controlled by a person, as a part of a VAT group.

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- May the VAT group refer to the new legal case with respect to past periods?

- Is it possible, from a procedural perspective, that only one shareholder retroactively refers to the new case law (e.g. in the case of definitive VAT assessment of the other company involved)?

- Do the tax authorities retroactively apply the new judgments themselves (in the case of financial effects)? Are there differences between the various stages of procedure (no annual VAT return, verification by a later tax audit, definitive assessment)?

2. Order of the Upper Tax Authority Frankfurt/Main

Some of the questions are targeted by the order of the Upper Tax Authority Frankfurt/Main of 24 May 2016 (S 7105 A – 22 – St 110). In this order, the results of the meeting of the heads of unit regarding VAT (federal and state government) have been published:

- The consequences of the above mentioned judgments are to be examined by the working group set up to study the reform of VAT groups. Therefore, the regulations of the Upper Tax Authority are preliminary in nature.

- The judgments by the Federal Fiscal Court are initially not to be applied to other individual cases.

- Both the controlling and the controlled company may refer to the new case law together, provided a VAT group exists in accordance with the opinions of both Federal Fiscal Court's Senates. In this case, an entrepreneur or financially integrated persons are required to hold all of the GmbH & Co. KG's shares. Furthermore, there needs to be a financial, economic and organizational integration at the time of the referral. It seems that legitimate expectations, in accordance with sec. 176 German General Fiscal Code, in this case are not protected (without justification).

3. Impact on the practice

What is positive is the fact that an administrative opinion, which was coordinated within the tax authorities and federal and state governments, was published for the first time. The tax offices now have a basis for deciding clear-cut cases in accordance with the new legal case by the Federal Fiscal Court. There may, as a result, be benefits for taxable persons. For example, in the case of insolvencies or denial of VAT deduction from group-internal invoices, one could develop new lines of argumentation. As long as the tax authorities do not apply the judgments generally, there are no resulting disadvantages.

On the other hand, however, substantive law issues remain open. This was bound to happen. The main causes of this uncertainty are the divergent approaches of the two VAT-Senates by the Federal Fiscal Court. The tax authorities are not required to and may not ultimately answer these questions. From what we know, a new letter from the German Ministry of Finance is to be expected before the end of the year.

As a procedural point, we believe that the refusal of legitimate expectations in accordance with sec. 176 German General Fiscal Code is not correct. There may be development potentials if only one of the two companies is integrated into the potential VAT group. It is possible that the tax assessment is only to be changed for one company.