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KMLZ VAT NEWSLETTER

Court provides clarification on VAT-groups regarding organizational integration

It is difficult for corporations to establish the organizational integration for a VAT-group. Recently, the V. Senate of the Federal Fiscal Court interpreted this feature very strictly. Now, however, it is the V. Senate which, by judgment of 10 May 2017 – V R 7/16, has stated that an organizational integration is possible even in the absence of personnel interweaving of the executive bodies, if a controlling and profit-and-loss transfer agreement exists.

Organizational integration by means of controlling agreement

1. Facts

A company (GmbH), which held 100% of the shares in another company (C-GmbH), filed a complaint. By notarial agreement of 29 October 2007, the applicant, as the controlling company, concluded a controlling and profit-and-loss transfer agreement with C-GmbH This was registered in the commercial register on 4 December 2007. The sole managing director of the applicant was S. The managing directors of the C-GmbH were T and K. After a tax audit the tax office had assumed a VAT-group since the relevant year (2007).

The applicant argued that there was no organizational integration. The managing directors in the controlling company and in the controlled company were different people. The controlling and profit-and-loss transfer agreement could not replace this fact. Moreover, the applicant did not, in fact, provide any instructions to C-GmbH. Thus, the dispute concerned the issue of organizational integration.

2. Legal assessment of the Federal Fiscal Court

In order to establish a VAT-group, the financial, economic and organizational integration of the subsidiary into the company of the parent company is necessary. In this case, the Federal Fiscal Court also recognized, in particular, the organizational integration. The organizational integration was based on the controlling and profit-and-loss transfer agreement without the managing directors in the controlling company and in the controlled company being the same. A legal person is organizationally integrated into the company of the VAT-group if the controlling company is responsible – due to the financial integration – for managing the subsidiary in the current management, and exerts a dominant influence on the VAT-group. If the legal person, in direct (in the case of stock companies) or analogous application of the company law, directs the management of its company to a company other than the controlling company, the controlling agreement establishes the organizational integration.

Regarding a GmbH as a controlled company in a VAT-group, the Federal Fiscal Court further emphasized that the

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majority shareholder, (resulting from the financial integration), pursuant to sec. 46 no. 6 Limited Liability Companies Act, is also responsible for the examination and monitoring of the management of the controlled company and, by execution of this right, is entitled to give instructions regarding the implementation of the resolutions of the shareholders' meeting. However, according to the case law, this right of instruction does not fulfill the independent criterion of organizational integration.

Something different applies regarding further rights from the controlling agreement. These rights lead to an organizational integration, since the right of instruction pursuant to sec. 308 German Stock Corporation Act applies not only to the supervision, but also to the management of the company (see sec. 76 no. 1 German Stock Corporation Act). In contrast to the right of instruction of the majority shareholder, which only allows for the possibility of impacting on individual ongoing matters, the right of instruction under sec. 308 German Stock Corporation Act includes the management of the company, the corporate representation and measures within the company's internal relationship, including accounting. Instructions may thus be given to the managing director of the dependent company directly, without the need to go through the shareholders' meeting. Consequently, the controlling agreement legally ensures the primacy of the VAT-group.

In the case of this dispute, the applicant was the controlling company of the C-GmbH on the basis of the contract dated 29 October 2007. As this agreement became effective only upon entry into the commercial register on 4 December 2007, the C-GmbH was integrated into the applicant from that point in time.

3. Effects on the practice

Due to the current case law at national and European level, and because of the recently published letter of the German Ministry of Finance of 26 May 2017, the legal institution of the VAT-group is increasingly becoming a subject of discussion. However, the prerequisites for the VAT-group must be legally watertight because the legal consequences come into force in the absence of any personal decisions. Against this background, the decision is not to be underestimated in terms of legal clarity. Last year the XI. Senate of the Federal Fiscal Court ruled, in its judgment of 12 October 2016 – XI R 30/14, on organizational integration and held that, for their acceptance, instructions given by a shareholders' meeting or a managing director of the parent company are sufficient. This decision, which was very welcome from a practitioner’s point of view, is now followed by this no less pleasing decision. The fiscal authorities assumed financial integration, even on the basis of the existence of a controlling agreement pursuant to sec. 291 Stock Corporation Act (sec. 2.8 para. 10 sentence 4 German VAT Circular). However, for the first time, the V. Senate made it clear that the controlling and profit-and-loss transfer agreement establishes the organizational integration. In particular, the explicitly mentioned analogous application in the Limited Liability Companies Act provides for clear conditions.

A negative issue regarding the controlling and profit-and-loss transfer agreement is, of course, the civil liability of the controlling company under this agreement. It is obliged to offset the losses of the dependent company. This is not always desirable in practice, as subsidiaries are also established in order to concentrate the liability risk on the subsidiary.