KÜFFNER MAUNZ LANGER ZUGMAIER

KMLZ VAT NEWSLETTER

VAT group: Can only taxable persons be the controlling company? – pending before the Federal Fiscal Court

Requirements for a consolidated VAT group

Sec. 2 para. 2 no. 2 of the German VAT Act regarding the requirements for a consolidated VAT group is formulated more restrictively than the underlying art. 11 of the VAT Directive. Therefore, entrepreneurs often refer to the EU law which is, in many cases, often more favorable for them. Although the tax court Saarland rejected the direct application of art. 11 of the VAT Directive in the particular case, entrepreneurs should continue to refer to this regulation until the Federal Fiscal Court clarifies this issue.

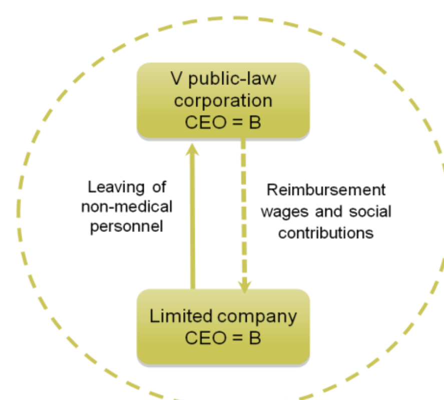
1. Problem

According to sec. 2 para. 2 no. 2 of the German VAT Act, commercial and professional activities shall not be regarded as being exercised independently if, based on the overall view of the actual relationships, a legal person is integrated into the enterprise of the controlling company from a financial, economic and organizational perspective (consolidated VAT group). It was for the tax court Saarland to decide whether a person, who is not a taxable person, (contrary to the wording of the regulation), can be the controlling company.

In 2013, the ECJ ruled that art. 11 of the VAT Directive does not prohibit including non-taxable persons in a consolidated VAT group. Since then, the question of whether it is compulsory for non-taxable persons to be part of a consolidated VAT group, has been in dispute. It is also questionable whether an entrepreneur may refer directly to the European regulations regarding a "VAT group".

2. Facts of the case before the tax court Saarland

A public law corporation (V), provided contractual medical care in accordance with sec. 75 para. 1 sentence 1 of the Social Code V. The corporation did not perform any taxable supplies. A limited company, 100% of the shares of which were held by V, performed tasks that V discharged in accordance with Social Code V. This limited company basically hired non-medical personnel and then left all ongoing responsibility to V. The wages and social contributions of the personnel was reimbursed to the limited company by V. Both V and the limited company had the same CEO.



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3. Decision by the tax court Saarland – 1 K 1480/12

The tax court decided that the reimbursement of wages and social contributions constituted a remuneration for the hiring of personnel. Only in the case of a consolidated VAT group, between V and the limited company, would there be no existing taxable supply between the two. These supplies would then be considered to be non-taxable internal transactions.

The tax court rejected the existence of a consolidated VAT group although the requirements of the financial, economic and organizational integration were met. The court justified this decision by reference to the missing commercial or professional activities by V. According to the wording of the German law, only taxable persons can be the controlling company (as previously decided by the tax court Saxony). It is permissible under EU law not to include persons who are non-taxable persons as a controlling company in order to avoid tax fraud.

However, even if the German regulations regarding the consolidated VAT group were applied unconstitutionally by the legislator, the limited company would not be able to refer to EU law in order to justify a VAT group. The tax court had serious doubts that art. 11 of the VAT Directive was precise enough. Otherwise, the taxable person would have an option to use the VAT group, which is not provided by law. It would be for the controlled company to "reclassify" the controlling company as a taxable person. By doing this, they would expose the controlling company to significant VAT obligations without them knowing this.

4. Practical tips

The tax court Saarland deals with the interface between EU and German law in its judgment. It has been in dispute for quite some time whether the German legislator has interpreted EU regulations regarding a "VAT group" correctly. The wording of the German law is more precise and strict at several points than the EU regulation. The ECJ ruled that the national legislator may only implement art. 11 of the VAT Directive "completely or not at all". The national legislator is only entitled to restrictions in order to prevent abuse.

As individuals may not refer directly to the EU norm, the tax court rejected the option to use the VAT group via the "backdoor". However, the arguments provided are legally doubtful. From our point of view, there are strong arguments for supplies of the controlled company to a non-taxable person or into a non-taxable area of their controlling company to be characterized as non-taxable internal transactions.

There are several further questions pending due to the differences between the German and EU Norm:

- Should supplies of a controlled company to the non-taxable area of their controlling company be considered as non-taxable internal transactions?
- Should there be an "integration" or is it sufficient if there is a "close connection" between these two companies?
- Is it possible for partnerships to be controlled companies? Is it necessary to differentiate between a GmbH & Co KG and other partnerships?
- Are organizational links actually missing in the case of so called "Patt situations"?

Entrepreneurs should continue to refer to the EU law – if it is more favorable for them – until the Federal Fiscal Court or the ECJ have definitively commented on these still pending questions.

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