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VAT'S UP

VAT NEWSLETTER

Potential for structuring: VAT group also includes non-economic activities

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1 Background

We previously provided an initial classification of the two ECJ judgments of 01.12.2022 on the VAT group in our KMLZ Newsletter 48 | 2022. Germany has rightly designated the controlling company as the tax debtor. The German regulation is thus essentially in conformity with EU law. Unfortunately, – and this is the downside of the judgments – by answering the questions referred, the ECJ has also raised new ones: May supplies within the VAT group continue to be treated as non-taxable internal transactions? And does the latter also apply to supplies to the non-economic sector?

It is worthwhile taking a closer look at these two questions as they play a major role in the context of VAT structuring advice. The VAT group is of particular interest if one party of the group is not entitled to deduct input VAT, for example because it renders VAT-exempt supplies or carries out non-economic and thus non-taxable activities. The latter is always the case with "mixed entities" under VAT law, i.e. legal entities which, in addition to economic activities, also engage in non-economic activities, which, however, do not serve any purpose outside the taxable person. This includes, for example, legal entities under public law with sovereign activities, non-profit organisations, insofar as they have a non-economic "idealistic" area, or mixed holding companies which are partly limited to holding shares.

2 ECJ judgment of 01.12.2022 (Case C-269/20, Finanzamt T).

In this case, a public corporation held 51% of the shares of a limited liability company. It was established that a VAT group existed between the two companies. The limited liability company provided cleaning services to the shareholder for a building, which the shareholder used for economic activities, as well as for sovereign (non-economic) activities. The Federal

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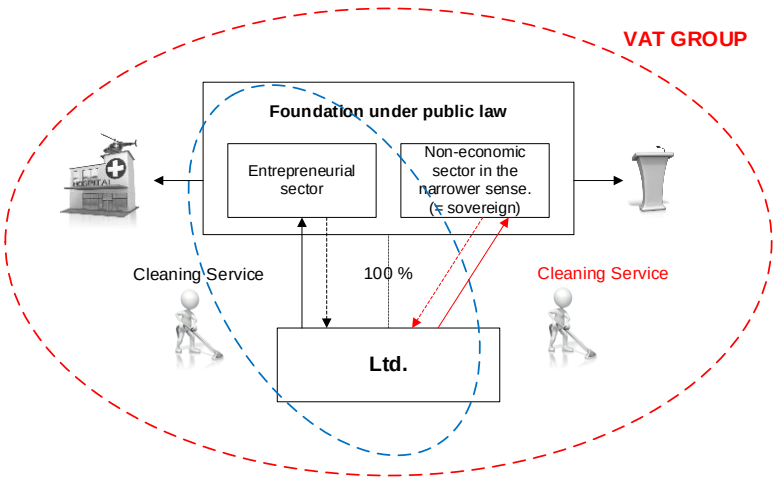
Fiscal Court determined that the VAT group also includes the sovereign sector (red circle). However, it raised the question with the ECJ as to whether the supplies to the sovereign sector are to be taxed as a supply carried out free of charge.



The ECJ confirms that the VAT group also includes the sovereign sector. In addition, no supplies carried out free of charge are to be taxed. With reference to its *VNLTO* jurisprudence, the ECJ correctly bases this on the fact that non-economic activities serving no purpose outside the taxable person, such as sovereign activities, do not constitute activities "for purposes other than those of his business" within the meaning of Article 6 (2) (b) of the Sixth Directive (which corresponds to the current Article 26 of the VAT Directive). Moreover, there would be no supplies carried out free of charge since the cleaning services were provided for consideration. However, this excellent result would be obsolete if the internal transactions for consideration constituted "normal taxable supplies". The ECJ – unlike the Advocate General in her Opinion – did not make any explicit statement regarding this issue. Nor did it have to do so, since it was not explicitly asked about it. In our opinion, there are many reasons why internal transactions continue to be non-taxable. The ECJ has already stated this in several judgments (cf. *Ampliscientifica* and *Amplifin* [rec. 19]; *Skandia America* [rec. 29]; *Kaplan International colleges UK* [rec. 45 f.], *Danske Bank* [rec. 25] and also *Commission v. Ireland* [rec. 32]). The same results from the grounds of the Commission proposal (COM[73] 950, rec. 3.4.3.), to which the ECJ itself refers in rec. 43. It would be nice if the Federal Fiscal Court would now clarify this in its subsequent decisions.

3 Consequences for the practice

If, contrary to expectations, internal transactions are classified as taxable, the legislator would finally have to react. Many companies have split up for reasons outside of tax law and would like to ensure, through the formation of a VAT group, that VAT on internal services does not become a cost factor. The latter is always the case if a member of the group is not entitled to deduct input VAT. Insofar as internal services continue to be non-taxable, we would finally have certainty for public corporations, non-profit organisations and mixed holding companies: the VAT group also includes the non-economic activities serving no purpose outside the taxable person. The tax authorities would have to make a clarification in sec. 2.8. para. 1 p. 5 of the German Administrative VAT Guidelines. There is no need to fear tax losses. When purchasing goods or services from third parties for the VAT group, the input VAT deduction would have to be reduced. Own personnel costs within the VAT group, however, would no longer be subject to VAT. This would be a great achievement for public corporations and the entire non-profit sector.

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