



KMLZ VAT NEWSLETTER

Holding companies and VAT groups – Part II

1. Background

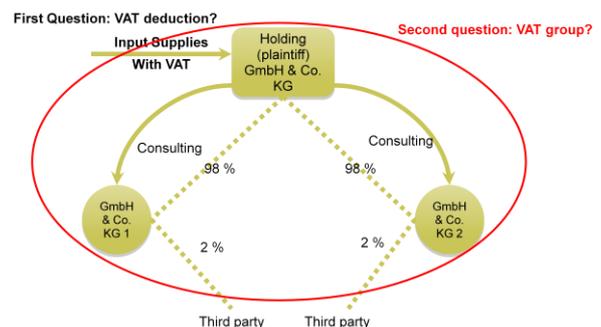
Just as a quick reminder: There were two legal cases awaiting decision by the Federal Fiscal Court. The Federal Fiscal Court joined the two appeals and referred them to the ECJ to decide whether a management holding company is entitled to full input VAT deduction, as the expenditure is partially connected to the non-taxable acquisition and holding of investments. The ECJ objected to the position of the German Federal Fiscal Court by judgment of 16.07.2015 (C-108/14, C-109/14, *Larentia + Minerva*). The ECJ confirmed that there is a right to fully deduct VAT if the holding company engages in the administration of the subsidiary and therefore generates taxable supplies. Regarding another question referred by the Federal Fiscal Court, namely whether a partnership may be a controlled company in a VAT group, the ECJ decided that this would generally be possible. Something different may apply only if Germany decided to intentionally exclude partnerships as controlled companies in order to prevent tax fraud. The Federal Fiscal Court closed the first proceedings with its judgment of 19.01.2016 (XI R 38/12) (see Newsletter 8/2016). With its judgment of 01.06.2016 it has now handed down a second decision.

Federal Fiscal Court further clarifies the themes holding companies and VAT groups

Following the ECJ decision in the proceedings *Larentia + Minerva* – judgment of 01.06.2016 (XI R 17/11), the Federal Fiscal Court has now handed down a second decision. It has determined that a management holding company is entitled to full deduction of input VAT amounts incurred in connection with the acquisition of shares in a subsidiary. It reiterates that a limited partnership, with a limited liability company as a general partner, (in the following: GmbH & Co. KG) is deemed to be a potential controlled company. We are pleased to hear that the XI Senate – unlike the V Senate – considers an organizational integration to be possible, even in the absence of the right to intervene.

2. Facts

A holding company held shares in two GmbH & Co. KGs. The limited partner share added up to 98% in each case. The holding company rendered consulting services against consideration to the two subsidiaries. The holding company raised capital. Part of this capital was used for the acquisition of the subsidiaries. Input VAT deduction was claimed by the holding company with respect to the costs incurred in this regard.





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The Federal Fiscal Court was required to decide whether the holding company was entitled to full input VAT deduction. As a second step, another question required clarification, namely whether it was possible for the holding company to form a VAT group with subsidiaries taking the legal form of a GmbH & Co. KG. Both questions were answered in the affirmative by the Federal Fiscal Court.

3. Full input VAT deduction for management holding companies

A holding company is deemed to be a taxable person if it renders supplies against remuneration to all its subsidiaries (= management holding company). The Federal Fiscal Court rejects the German tax authority's approach, stating that such holding companies also have a non-taxable sector. Therefore, any input VAT deduction is basically not subject to reduction. The only possible exception to this would be abusive practice. In the case at hand, the Federal Fiscal Court, found no such abusive practice. No assumption of such abuse should, in particular, be derived in terms of the amount of the remuneration for the supply of services rendered. This statement is important for the practice.

4. VAT group also with partnerships

The Federal Fiscal Court followed the case law of the V. Senate and concluded that, although the wording of sec. 2 para. 2 no. 2 of the German VAT Act only states legal persons, a partnership may well be a potential controlled company. It justified this by the interpretation of the term "legal person", in conformity with the VAT Directive. The V. Senate was even stricter, as it required the controlling company to hold 100% of the shares. This was not the situation in the case at hand due to a share of only 98%. At the same time, however, the XI. Senate considered it possible

that the holder of shares in an amount of 98% may still result in an integration of a partnership. The XI. Senate was not required to and could not decide more than that. The determinations, as regards the possible integration of a partnership, which were made at first instance were not sufficient and thus will have to be reheard. The relevant point is whether the GmbH & Co. KGs are, *according to the overall actual circumstances, financially, economically and organizationally* integrated into the controlling company.

Above all, the final sentences of the judgment give cause for optimism. Therein, the XI. Senate challenges the V. Senate's strict view as regards the requirement of integration with the right to intervene. Thus, the XI. Senate expressly left open the question of whether personal ties between the two companies, via the management, need to exist. This openness is essential, as particularly in corporate structures, personal ties cannot be created via the management. It is positive, though that, in its judgment, the Federal Fiscal Court, seeks to examine why the legal institution of VAT groups exists at all. It serves merely as an administrative simplification for companies.

5. What is going to happen?

The federal and state governments have been discussing, for some time, how to treat these judgments. It is definite, that a legal change of group taxation regulations is not necessary (even if a determination procedure with the right of application were to prove the best solution). The Federal Ministry of Finance is said to be preparing to issue a circular according to which partnerships - at least with 100 % integration - may act as controlled companies. The transitional arrangement will be interesting, above all, if and who may invoke to the new jurisprudence.