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ECJ Decisions Confirm Nontaxable Persons Can Be Part of VAT Group

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The European Court of Justice on April 25 confirmed in five decisions — *Commission v. Netherlands* (C-65/11), *Commission v. Finland* (C-74/11), *Commission v. U.K.* (C-86/11), *Commission v. Denmark* (C-95/11), and *Commission v. Czech Republic* (C-109/11) — that a nontaxable person can be a member of a VAT group. The decisions follow the April 9 ECJ decision in *Commission v. Ireland* (C-85/11).

In *Commission v. Netherlands*, the Court specifically addressed whether ''top holding companies'' may be included in a VAT group.

VAT Groups

Under article 11 of the VAT directive (Council Directive 2006/112/EC of November 28, 2006, on the common system of VAT), each member state, after consulting the advisory committee on VAT, may regard any persons established in the territory of that member state that are, while legally independent, closely bound to one another by financial, economic, and organizational links, as a single taxable person, a VAT group.

Several member states have exercised this option, treating each VAT group as a separate, independent taxpayer. Members of a VAT group can make intercompany supplies of goods and services without charging VAT. To the extent that all members of a VAT group can fully recover VAT, the benefits of a VAT group are cash flow advantages and administrative simplification.

However, to the extent that not all members of a VAT group can recover input VAT in full, or at all, the existence of a VAT group may also yield a saving of VAT. Intra-VAT-group supplies are not subject to VAT, which if charged might otherwise not have been fully deductible for the member of the VAT group acquiring the services. On the other hand, the inclusion in a VAT group of one or more members that are not eligible for full recovery of input VAT may result in some of the VAT charged by non-VAT-group members to VAT group members being unrecoverable, even if the VAT is related to purchases made by a member that in the absence of a VAT group would have been entitled to full recovery of all input VAT. Despite this possible (negative) impact on the recoverability of VAT charged by third parties, a significant VAT savings can still be achieved if there are substantial intra-VAT-group supplies of services or goods, if the cost price of the intra-VAT-group supply mainly consists of items that are not subject to VAT, like labor.

On the basis that article 11 of the VAT directive refers to ''persons'' that can be included in a VAT group, rather than to ''taxable persons,'' several member states allow nontaxable persons (that is, persons that do not carry on a business activity) to become part of a VAT group. In 2011 the European Commission instituted infringement proceedings against these member states (the United Kingdom, Ireland, the Czech Republic, Denmark, Finland, and the Netherlands), arguing that these member states failed to fulfill their obligations under articles 9 and 11 of Directive 2006/112/EC by permitting nontaxable persons to join a VAT group. The European Commission argued that article 11 of the VAT directive should be interpreted as allowing member states to only treat taxable persons, rather than persons, as members of a VAT group. The European Commission was concerned that these rules could give rise to potential abuse and breach of fiscal neutrality because the advantages of VAT registration would be available to nontaxable persons in a VAT group but not to nontaxable persons outside a VAT group.

Commission v. Ireland

On April 9, in *Commission v. Ireland*, the ECJ held in favor of an Irish provision accepting a nontaxable person as a VAT group member, supporting a plain-language reading of article 11 of the VAT directive. (Prior coverage: *Tax Notes Int'l*, Apr. 15, 2013, p. 222.) The Court held that:

> it is apparent from the wording of the first paragraph of Article 11 of the VAT Directive that that directive permits each Member State to regard a number of persons as a single taxable person if they are established in the territory of that Member State and if, although they are legally independent, they are closely bound to one another by financial, economic and organisational

links. The application of that article is not, according to its wording, made subject to other conditions, in particular to the condition that those persons could themselves, individually, have had the status of a taxable person within the meaning of Article 9(1) of the VAT Directive. As it uses the word ''persons'' and not the words ''taxable persons,'' the first paragraph of Article 11 of the VAT Directive does not make a distinction between taxable persons and non-taxable persons.

Commission v. Netherlands

In C-65/11, the European Commission disputed the legality of the Dutch policy set out in the resolution of February 18, 1991, (No. VB91/347) — commonly referred to as the holding resolution — which allows, subject to certain conditions, top holding companies to be included in a VAT group. According to this resolution, top holding companies are companies that do not offer services for payment but whose role within the VAT group is one of steering and policymaking. In its April 25 decision, the ECJ held that these top holding companies, although nontaxable persons, can indeed be part of a VAT group.

It appears that the Dutch policy regarding top holding companies does not need to be amended. However, given that the Dutch policy is limited to such top holding companies, it seems that the scope of the policy should be broadened to also include other kinds of nontaxable persons.

Restriction to Certain Sectors Allowed

In *Commission v. Finland* (C-74/11), the European Commission brought an additional objection against Finland: that Finland has narrowed the scope of its VAT groups to businesses active in the financial services and insurance industries. This same objection was made against Sweden, which applied a similar restriction, in *Commission v. Sweden* (C-480/10).

In both cases, the ECJ on April 25 held in favor of the member states. The Court accepted the contention of both member states that the financial supervision to which the ring-fenced businesses were subject provided additional safeguards against evasion and fraud and that such measures, according to the states, should therefore be justified in light of paragraph 2 of article 11 of the VAT directive, according to which ''a Member State exercising the option provided for in the first paragraph, may adopt any measures needed to prevent tax evasion or avoidance through the use of this provision.'' In the absence of any convincing counterargument by the European Commission, the Court found this to be sufficient justification of the unequal treatment of other businesses that are denied the privilege of forming a VAT group. ◆

♦ *Anton Louwinger, tax partner, Hogan Lovells, Amsterdam*