

*Sebastian Pfeiffer*

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# VAT Grouping from a European Perspective

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34

# VAT Grouping from a European Perspective

## Why this book?

In theory, VAT is a neutral tax and should not become a burden for companies. On that account, the business decision to insource or outsource activities should be irrelevant for the VAT treatment. However, the current EU VAT regime is (partly) harmonized and does not generate neutrality for all companies involved, i.e. companies not able to (fully) deduct input taxes. Member States are granted an option for introducing a VAT grouping regime that allows legally independent persons to be treated as one single taxable person under certain conditions. The main consequence of VAT grouping is that it leads to out-of-scope intra-group transactions, enabling companies to outsource functions without running the risk of non-deductible VAT. The notion of EU VAT grouping stems from the German Organschaft regime, which was originally introduced to produce neutrality within the chain of companies.

This book provides an overview of VAT policy considerations for introducing VAT grouping and the history of the EU VAT grouping notion, and offers an in-depth analysis of the scope of the VAT grouping notion found in the VAT Directive. While elaborating on the scope of the VAT grouping concept, the fundamental freedoms relating to the territorial scope and State aid provisions with respect to the personal scope are scrutinized. The scope of VAT grouping is furthermore analysed in the light of the ECJ's case law on VAT grouping, VAT in general and other case law relevant to the topic.

After a thorough analysis of the Member States' domestic implementation of the VAT grouping regime, the book further covers the consequences of VAT groups in domestic and cross-border contexts and discusses the rights and obligations of a VAT group, ranging from the place of supply to the right to deduct input taxes. Lastly, the book contains a comparison of the EU VAT exemption for cost-sharing arrangements and VAT grouping and discusses their possible interaction.

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## VAT Groups of Companies: A Glance from the Policy Perspective

### 1.1. General remarks

VAT<sup>1</sup> is targeted at taxing final consumption expenditure on the level of individuals.<sup>2</sup> However, VAT is not the only option to tax consumption. On the contrary, forms of retail sales taxes also constitute means of taxing final household consumption. Nevertheless, the biggest difference between VAT and other forms of consumption taxes is the fact that VAT is levied on all stages and imposed on all stages of production and distribution on supplies of both goods and services.<sup>3</sup> Put in other words, a VAT is defined to be “[a] broad-based tax levied on commodity sales up to and including, at least, the manufacturing stage, with systematic offsetting of tax charged on commodities purchased as inputs – except perhaps on capital goods – against that due on outputs”.<sup>4</sup> The main advantage of a VAT in comparison to other consumption taxes lies in the fact that, on the one hand, revenue is secured by collection throughout the process of production – in contrast to retail sales taxes – but, on the other hand, does not distort production decisions – as is the case with a turnover tax.<sup>5</sup>

### 1.2. VAT policy rationale for VAT grouping

The system of a VAT is closely linked to the fact that within the chain of companies input taxes are deductible in order to neutralize the tax effects.

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1. For the purposes of VAT policy there is no difference between a VAT and a GST (Goods and Services Tax). Therefore, whenever there is a reference to VAT, GST systems are also covered.

2. See S. Hemels, *Influence of Different Purposes of Value Added Tax and Personal Income Tax on an Effective and Efficient Use of Tax Incentives: Taking Tax Incentives for the Arts and Culture as an Example*, in *Value Added Tax and Direct Taxation – Similarities and Differences* p. 37 (M. Lang et al. eds. & T. Ecker ass. ed., IBFD 2009).

3. See S. Cnossen, *A Primer on VAT as Perceived by Lawyers, Economists and Accountants*, in *Value Added Tax and Direct Taxation – Similarities and Differences* p. 126ff (M. Lang et al. eds. & T. Ecker ass. ed., IBFD 2009).

4. See L. Ebrill et al., *The Modern VAT* p. 2 (IMF 2001).

5. See R. Bird & P. Gendron, *The VAT in Developing and Transitional Countries* p. 10 (Cambridge University Press 2007); see also A. Charlet & J. Owens, *An International Perspective on VAT*, 59 *Tax Notes Intl.* 12, p. 944 (2010).

Thus, in general, the question of VAT policy and groups of companies is – from the point of view of the actual tax burden – irrelevant: As VAT levied on supplies of goods and services between companies, i.e. taxpayers, is deductible, the choices of production are independent from the tax levied on them. Therefore, in a “perfect” world, the taxation of supplies between groups of companies is neutral. This statement loses its merits when one takes into account that certain supplies are not subject to VAT, i.e. exempt, with the effect that such exemptions bar the traders from deducting input taxes – at least partially.<sup>6</sup> If this basic mechanism of VAT is taken into account when looking at groups of companies, the question whether activities are insourced or outsourced does not solely depend on purely operational or economic considerations, but also needs to consider VAT consequences, if – within the chain of the group – at least one company is subject to input tax deduction limitations.<sup>7</sup> This is the consequence of a (partial) denial of VAT relief. As long as the supply of these exempt goods and services remains within the chain of companies, VAT becomes a cost factor in the amount of the non-deductible input taxes.<sup>8</sup> Therefore, the effect of non-deductible VAT within the chain of group companies can influence the group’s structure with regard to the creation of specialized entities to which selected functions could be allocated, i.e. outsourcing.<sup>9</sup> That being said, many VAT systems – including the EU VAT system – provide for an incentive to insource rather than outsource, which is in tension with the proposed neutrality of VAT.<sup>10</sup> In situations where not all members of a group of companies are able to fully offset VAT the incentive to insource rather than outsource will gain relevance. In addition to the aspect of structural efficiency of groups of companies, which serves as a puzzle piece of VAT neutrality, VAT grouping regimes also contribute to an equal treatment between business models: By allowing the grouping of companies for VAT purposes – at least to some extent – an equal situation between companies operating within one legal entity and those that operate through separate legal entities will be established.<sup>11</sup>

Amongst others, it is this tension between economically rational decisions towards vertical integration and disadvantageous VAT consequences which

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6. See Ebrill et al., *supra* n. 4, at p. 83.

7. See C. B. Eskildsen, *Insourcing and Outsourcing in a VAT Context*, 40 *Intertax* 8/9, p. 444 (2012); see also M. Lausterer, *Konzernstrukturen und Outsourcing*, in *Umsatzsteuer im Europäischen Binnenmarkt* p. 388 (R. Seer ed., Otto Schmidt 2009).

8. See OECD & IMF, *The Value Added Tax – Experiences and Issues* p. 12ff (2012).

9. See A. Parolini et al., *VAT and Group Companies*, 65 *Bull. Intl. Taxn.* 6, p. 349 (2011), *Journals IBFD*.

10. See Eskildsen *supra* n. 7, at p. 445; Parolini et al., *supra* n. 9, at p. 349.

11. See OECD, *VAT Group Taxation* p. 13 (2012).

gives the incentives for domestic legislators to introduce VAT grouping regimes in general.<sup>12</sup> Indeed, there are certain other beneficial advantages for the group members which follow the basic choice of states to introduce VAT grouping:<sup>13</sup> A VAT grouping regime can increase the companies' cash-flow efficiency on the one hand by reducing the amounts of input and output VAT within the group and, on the other hand, by allowing the offset between excess VAT credits and liabilities of the VAT group's members.<sup>14</sup> Additionally, by grouping entities together, the group's compliance burden and the risks associated with it are – to some extent – minimized. In general, the VAT group will only provide for a consolidated VAT return by its representative group member,<sup>15</sup> which can be connected with a joint liability of the individual VAT group members.<sup>16</sup> Simultaneously, the actual VAT payment can be simplified as well by obliging one group member to pay the group's total VAT due or apply for a refund of an input tax credit.<sup>17</sup>

However, VAT grouping regimes are not only favourable for the taxpayers involved. On the contrary, tax administrations may gain advantages due to the fact that they face a reduced number of companies to be audited. Furthermore, VAT grouping regimes can also be beneficial from an anti-avoidance point of view:<sup>18</sup> By having a mandatory grouping regime the risk of fraudulent VAT refunds created on the basis of intra-group transactions can be minimized. Moreover, VAT grouping regimes may act as a “corrective” for the incentive for large entities to split up in order to make use of special regimes for small and medium-sized enterprises. This rationale gains even more importance where the threshold for applying the VAT system is set high.<sup>19</sup>

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12. See Parolini et al., *supra* n. 9, at p. 350.

13. The extent of these advantages will to some extent depend on the actual framing of the VAT grouping system.

14. OECD, *supra* n. 11, at p. 14.

15. See, for example, the German and Austrian system of *Organschaft* where the *Organträger* will have these obligations. Similarly, also the British VAT grouping system depends on a representative group member who will bear the group's administrative obligations.

16. For an overview see below at ch. 10, sec. 10.2.

17. OECD, *supra* n. 11, at p. 14. See also S. Kirsch & P. Gamito, *VAT groupings and their cross-border consequences – between channeling and infringement of freedom of establishment*, 10 *Tax Planning Intl Indirect Taxes* 4 (2012).

18. OECD, *supra* n. 11, at p. 15.

19. Such thresholds should indeed not be set too low. It is, therefore, a basic VAT policy recommendation to set the threshold rather higher than lower since “[e]xperience suggests that many countries have tended to set the threshold too low, putting themselves in considerable difficulty when their tax administration is found to be insufficiently developed to administer a large VAT population”. For further examples and explanations, see OECD & IMF, *supra* n. 8, at p. 13ff. It can therefore be argued that the thresholds within the European Union are set rather low in an international comparison.

### 1.3. Forms of VAT grouping from a VAT policy perspective

After identifying the basic policy motivations to introduce a VAT grouping regime in the first place, legislators are faced with the question of how to embody a grouping system in their domestic laws. Indeed, there are several approaches found in various VAT legislations with both advantages and disadvantages when compared to each other:<sup>20</sup> VAT grouping regimes can follow a “fiscal unity model” where the group’s legal structure is disregarded for VAT purposes and its entities are treated as if they were acting as one single entity.<sup>21</sup> Another alternative consists in financial consolidation by which each group member calculates its tax base and tax liability and subsequently transfers any VAT due or any input VAT credits to the parent company or the VAT group’s representative company.<sup>22</sup> Some states use a combination of both systems, i.e. the partial single-entity treatment for VAT grouping.<sup>23</sup> Thereby, each group member will be obliged to maintain its VAT registration but, nevertheless, the representative member will be obliged to take care of fulfilling most of the group’s VAT obligations.<sup>24</sup> In addition, there are systems that allow closely related companies to have their intra-group supplies to be deemed to be carried out at zero consideration with the effect that no VAT will be payable for them.<sup>25</sup>

20. OECD, *supra* n. 11, at p. 17.

21. This is the approach of the EU VAT grouping system. The New Zealand system of GST grouping also follows this approach. Norway, Singapore and Switzerland similarly apply such a system. For New Zealand see D. White & E. Trombitas, *New Zealand, in Improving VAT/GST – Designing a simple and fraud-proof tax system* (M. Lang & I. Lejeune eds., IBFD 2014), Online Books IBFD; for Norway see in general E. Qvist, *Norway, in Improving VAT/GST – Designing a simple and fraud-proof tax system* (M. Lang & I. Lejeune eds., IBFD 2014) Online Books IBFD. For Singapore see S. H. Koh, *Singapore, in Improving VAT/GST – Designing a simple and fraud-proof tax system* (M. Lang & I. Lejeune eds., IBFD 2014), Online Books IBFD. For Switzerland see C. Grosjean & N. Honauer, *Switzerland, in Improving VAT/GST – Designing a simple and fraud-proof tax system* (M. Lang & I. Lejeune eds., IBFD 2014), Online Books IBFD.

22. Such a notion can be found, inter alia in Spain. For a basic explanation of the Spanish system see *infra* n. 96 and the references there.

23. This is the case in Australia. See in greater detail R. Millar & L. Moon, *Australia, in Improving VAT/GST – Designing a simple and fraud-proof tax system* (M. Lang & I. Lejeune eds., IBFD 2014), Online Books IBFD.

24. Indeed, the Australian system excludes some transactions from the scope of the GST group, i.e. the GST on goods at the time of import (with exceptions). For a detailed overview see R. Millar & L. Moon, *supra* n. 23, at ch. 2.2.1.3.

25. This is the case in Canada for groups of companies other than financial institutions. The latter have the possibility to elect to have their intra-group supplies be treated as exempt supplies. See KPMG, *Canada – Country VAT/GST Essentials* p. 4 (2011).

In the light of this thesis, however, the EU VAT grouping notion which follows the “fiscal unity” or “single-entity” approach will be examined in detail. Nevertheless, it needs to be considered that all VAT grouping regimes presented have different scopes of application, ranging from the personal scope of these rules to the possibility and feasibility of cross-border grouping.



## Contact

IBFD Head Office  
Rietlandpark 301  
1019 DW Amsterdam  
P.O. Box 20237  
1000 HE Amsterdam, The Netherlands  
Tel.: +31-20-554 0100 (GMT+1)  
Email: [info@ibfd.org](mailto:info@ibfd.org)  
Web: [www.ibfd.org](http://www.ibfd.org)



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