Sebastian Pfeiffer

VAT Grouping from a European Perspective

IBFD DOCTORAL SERIES 34
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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Table of Contents

Foreword

Part One
Introduction

Chapter 1: VAT Groups of Companies: A Glance from the Policy Perspective 3
  1.1. General remarks 3
  1.2. VAT policy rationale for VAT grouping 3
  1.3. Forms of VAT grouping from a VAT policy perspective 6

Part Two
VAT Grouping in the European VAT Directive

Chapter 2: History of EU VAT Grouping 11
  2.1. EU VAT grouping: A European notion with German roots 11
  2.2. VAT grouping and its tracks in EU legislative history 16

Chapter 3: Personal Scope of VAT Grouping 21
  3.1. The Commission’s opinion 21
  3.2. Personal scope in Member States’ domestic VAT legislation 21
  3.3. Interpretation of the VAT grouping’s personal scope 25
  3.3.1. Literature review 25
  3.3.2. ECJ’s case law and its interpretation 28
  3.3.2.1. General remarks 28
  3.3.2.2. Grammatical interpretation 29
  3.3.2.3. Historical aspects 30
  3.3.2.4. Context and intention of Art. 11 VAT Directive as well as consequences of non-taxable persons joining a VAT group 31
  3.3.3. Non-taxable persons may join a VAT group 33
# Table of Contents

3.4. Limitations to VAT grouping 34  
3.4.1. Limitations to options from a general VAT perspective 34  
3.4.2. A parallel to the ECJ’s case law in direct taxation and the fundamental freedoms 44  
3.4.3. Limitations to VAT grouping as a state aid problem 48  
3.4.3.1. General remarks 48  
3.4.3.2. Intervention by the State or through state resources 50  
3.4.3.3. Favourable treatment and selectivity 53  
3.4.3.3.1. The question of favourable treatment 53  
3.4.3.3.2. Selectivity 54  
3.4.3.4. Adverse effect on trade 58  
3.4.3.5. Procedural issues 59  
3.5. Conclusion 60

Chapter 4: Territorial Scope of VAT Grouping 63  
4.1. Status quo and general remarks 63  
4.2. Compatibility of the VAT grouping’s territorial scope with the fundamental freedoms 64  
4.2.1. Affected fundamental freedom(s) 64  
4.2.2. Restriction of the fundamental freedoms 67  
4.2.2.1. A question of comparability 67  
4.2.2.2. Comparability pair 1: Domestic VAT group vs. cross-border parent-subsidiary treatment 69  
4.2.2.2.1. Companies involved have a full right of deduction 69  
4.2.2.2.2. Companies involved have a partial or no right of deduction 73  
4.2.2.3. Comparability pair 2: Cross-border headquarters-fixed establishment vs. cross-border parent-subsidiary 75  
4.2.2.3.1. General remarks 75  
4.2.2.3.2. VAT treatment of intra-branch transactions 77  
4.2.2.3.3. Application to cross-border supplies of goods 80  
4.2.2.3.4. Application to cross-border supplies of services 81  
4.2.2.3.5. Difference in treatment depends on the type of supply and degree of input tax deduction 81  
4.2.2.4. Interim result: The territorial scope restricts the fundamental freedoms 83  
4.2.3. Justification(s) 84  
4.2.3.1. General remarks 84  
4.2.3.2. Tax avoidance and tax evasion 85
<table>
<thead>
<tr>
<th>Section</th>
<th>Title</th>
<th>Page</th>
</tr>
</thead>
<tbody>
<tr>
<td>4.2.3.3</td>
<td>Harmonization and the fiscal sovereignty of the Member States</td>
<td>89</td>
</tr>
<tr>
<td>4.2.3.4</td>
<td>Effectiveness of fiscal supervision</td>
<td>92</td>
</tr>
<tr>
<td>4.2.3.5</td>
<td>Principle of territoriality</td>
<td>94</td>
</tr>
<tr>
<td>4.2.4</td>
<td>Proportionality</td>
<td>97</td>
</tr>
<tr>
<td>4.2.4.1</td>
<td>General remarks</td>
<td>97</td>
</tr>
<tr>
<td>4.2.4.2</td>
<td>Causal link between means and end</td>
<td>98</td>
</tr>
<tr>
<td>4.2.4.2.1</td>
<td>Similarity to intra-branch and intra-group transactions under the current ECJ case law</td>
<td>98</td>
</tr>
<tr>
<td>4.2.4.2.2</td>
<td>Final VAT burden in the light of final losses</td>
<td>99</td>
</tr>
<tr>
<td>4.2.4.3</td>
<td>Is there a least restrictive measure that could fulfil the objective of cross-border VAT groups?</td>
<td>101</td>
</tr>
<tr>
<td>4.2.4.3.1</td>
<td>General remarks</td>
<td>101</td>
</tr>
<tr>
<td>4.2.4.3.2</td>
<td>Taxation of intra-group transactions in the current EU VAT system</td>
<td>102</td>
</tr>
<tr>
<td>4.2.4.3.3</td>
<td>To tax, or not to tax, that is the question: A policy perspective</td>
<td>103</td>
</tr>
<tr>
<td>4.2.4.3.3.1</td>
<td>General remarks</td>
<td>103</td>
</tr>
<tr>
<td>4.2.4.3.3.2</td>
<td>The OECD VAT/GST Neutrality Guidelines: A step towards a separate-entity approach in VAT</td>
<td>105</td>
</tr>
<tr>
<td>4.2.4.3.3.3</td>
<td>Relevance for cross-border VAT grouping: The recharge method</td>
<td>108</td>
</tr>
<tr>
<td>4.2.4.3.4</td>
<td>Application of the recharge method to cross-border VAT grouping in the light of proportionality</td>
<td>111</td>
</tr>
<tr>
<td>4.2.4.4</td>
<td>Interim conclusion: Least burdensome measure to a territorial restriction is the taxation of intra-group transactions</td>
<td>112</td>
</tr>
<tr>
<td>4.2.5</td>
<td>Conclusion</td>
<td>113</td>
</tr>
<tr>
<td>4.3</td>
<td>Compatibility of the territorial scope with the principle of neutrality</td>
<td>116</td>
</tr>
<tr>
<td>4.3.1</td>
<td>Neutrality as the pillar of the EU VAT system</td>
<td>116</td>
</tr>
<tr>
<td>4.3.2</td>
<td>VAT grouping and neutrality of input tax recovery</td>
<td>117</td>
</tr>
<tr>
<td>4.3.3</td>
<td>VAT grouping and comparative neutrality</td>
<td>119</td>
</tr>
<tr>
<td>4.3.4</td>
<td>Conclusion</td>
<td>121</td>
</tr>
<tr>
<td><strong>Chapter 5:</strong></td>
<td><strong>Substantive Scope of VAT Grouping</strong></td>
<td>123</td>
</tr>
<tr>
<td>5.1</td>
<td>General remarks</td>
<td>123</td>
</tr>
<tr>
<td>5.2</td>
<td>Financial link</td>
<td>123</td>
</tr>
<tr>
<td>5.2.1</td>
<td>The Commission’s view</td>
<td>123</td>
</tr>
</tbody>
</table>
5.2.2. Examination of rules found in Member States having exercised the option to introduce a VAT grouping regime 124
5.2.3. Interpretation of the financial link 127
5.2.3.1. Case law related to VAT grouping 127
5.2.3.2. Case law regarding the differentiation between the fundamental freedoms 128
5.2.3.3. Other EU legislation 130
5.2.3.4. Current trends in the harmonization process in the area of direct taxation 131
5.2.4. Conclusion 133
5.3. Economic link 133
5.3.1. The Commission’s view 133
5.3.2. Economic links in Member States’ legislation and case law 134
5.3.2.1. Austria 134
5.3.2.1.1. General remarks 134
5.3.2.1.2. Detailed case law of the Austrian Supreme Administrative Court: ABC of economic links 135
5.3.2.1.3. Does the Austrian VAT grouping implementation require an economic “domination”? 136
5.3.2.1.4. Congruence with the Commission’s communication 138
5.3.2.2. Germany 139
5.3.2.2.1. General remarks 139
5.3.2.2.2. Detailed analysis of German case law on economic links 140
5.3.2.2.3. The significance of transactions between group members 141
5.3.2.2.4. German case law in the light of EU VAT grouping notion and other case law 144
5.3.2.3. Selected other Member States 145
5.3.3. Conclusions 147
5.4. Organizational link 148
5.4.1. The Commission’s view 148
5.4.2. Organizational links in Member States’ legislation and case law 148
5.4.2.1. Austria 148
5.4.2.2. Germany 150
5.4.2.3. Selected other Member States 153
5.4.2.4. Conclusions 154
5.5. Conclusion 155
# Table of Contents

## Chapter 6: Formal Scope of VAT Grouping

6.1. General remarks 157  
6.2. Legal quality of the consultation process 157  
6.3. Consequences of non-consultation 159

## Part Three  
Consequences of VAT Grouping

## Chapter 7: Mandatory or Optional Application

7.1. General remarks 163  
7.2. Literature review 163  
7.3. Own interpretation 167  
7.4. Conclusion 171

## Chapter 8: VAT Group as Separate Taxable Entity

## Chapter 9: Intra-Group Supplies of Goods and Services

9.1. General remarks 175  
9.2. Cross-border intra-group supplies 177  
9.2.1. The Commission’s view: A domestic VAT group with a foreign fixed establishment 177  
9.2.2. Own interpretation 178  
9.2.3. Application to cross-border intra-group transactions 185  
9.2.3.1. General remarks 185  
9.2.3.2. Cross-border intra-group transaction between two Member States having exercised the VAT grouping option 185  
9.2.3.3. Cross-border intra-VAT group transactions between a Member State having exercised the VAT group option and another Member State not having exercised the VAT group option 186

## Chapter 10: Rights and Obligations

10.1. Tax return: A proposed consolidation regime 193  
10.2. Liability 195  
10.2.1. General remarks 195
<table>
<thead>
<tr>
<th>Section</th>
<th>Description</th>
<th>Page</th>
</tr>
</thead>
<tbody>
<tr>
<td>10.2.2.</td>
<td>Joint liability in the light of the VAT Directive</td>
<td>195</td>
</tr>
<tr>
<td>10.2.3.</td>
<td>Joint liability of VAT group members in selected Member States</td>
<td>198</td>
</tr>
<tr>
<td>10.2.3.1.</td>
<td>Germany</td>
<td>198</td>
</tr>
<tr>
<td>10.2.3.2.</td>
<td>Austria</td>
<td>199</td>
</tr>
<tr>
<td>10.2.3.3.</td>
<td>Other Member States</td>
<td>200</td>
</tr>
<tr>
<td>10.3.</td>
<td>Place of supply</td>
<td>201</td>
</tr>
<tr>
<td>10.3.1.</td>
<td>General remarks</td>
<td>201</td>
</tr>
<tr>
<td>10.3.1.1.</td>
<td>The need for proxies in VAT legislation</td>
<td>201</td>
</tr>
<tr>
<td>10.3.1.2.</td>
<td>Place of supply of goods</td>
<td>202</td>
</tr>
<tr>
<td>10.3.1.3.</td>
<td>Place of supply of services</td>
<td>203</td>
</tr>
<tr>
<td>10.3.1.4.</td>
<td>Deemed intra-Union acquisition and intra-Union supply of goods and services</td>
<td>204</td>
</tr>
<tr>
<td>10.3.2.</td>
<td>Place of supply and fixed establishments</td>
<td>205</td>
</tr>
<tr>
<td>10.3.2.1.</td>
<td>General remarks</td>
<td>205</td>
</tr>
<tr>
<td>10.3.2.2.</td>
<td>The notion of fixed establishment</td>
<td>207</td>
</tr>
<tr>
<td>10.3.2.2.1.</td>
<td>Introductory remarks</td>
<td>207</td>
</tr>
<tr>
<td>10.3.2.2.2.</td>
<td>Fixed establishments in the light of the Implementing Regulation</td>
<td>207</td>
</tr>
<tr>
<td>10.3.2.2.3.</td>
<td>Fixed establishments in the light of the ECJ’s case law</td>
<td>209</td>
</tr>
<tr>
<td>10.3.2.2.4.</td>
<td>Consistency of the ECJ’s case law and the Implementing Regulation?</td>
<td>213</td>
</tr>
<tr>
<td>10.3.2.3.</td>
<td>Implications for cross-border VAT groups</td>
<td>216</td>
</tr>
<tr>
<td>10.3.2.4.</td>
<td>Force of attraction of fixed establishments</td>
<td>216</td>
</tr>
<tr>
<td>10.4.</td>
<td>Right to deduct input taxes</td>
<td>219</td>
</tr>
<tr>
<td>10.4.1.</td>
<td>General remarks</td>
<td>219</td>
</tr>
<tr>
<td>10.4.2.</td>
<td>Domestic VAT groups and the deduction of input taxes</td>
<td>220</td>
</tr>
<tr>
<td>10.4.3.</td>
<td>Cross-border VAT grouping and the deduction of input taxes</td>
<td>222</td>
</tr>
<tr>
<td>10.4.3.1.</td>
<td>Deduction or VAT refund?</td>
<td>222</td>
</tr>
<tr>
<td>10.4.3.2.</td>
<td>Issues connected to the input tax deduction and cross-border VAT groups</td>
<td>224</td>
</tr>
<tr>
<td>10.4.4.</td>
<td>Full, partial or no deduction of input taxes</td>
<td>227</td>
</tr>
<tr>
<td>10.4.4.1.</td>
<td>General remarks</td>
<td>227</td>
</tr>
<tr>
<td>10.4.4.2.</td>
<td>Full or no deduction? A question of the link!</td>
<td>227</td>
</tr>
<tr>
<td>10.4.4.2.1.</td>
<td>Direct and immediate link</td>
<td>227</td>
</tr>
<tr>
<td>10.4.4.2.2.</td>
<td>Direct and immediate link to the VAT group’s general overhead?</td>
<td>229</td>
</tr>
<tr>
<td>10.4.4.2.3.</td>
<td>Conclusions</td>
<td>231</td>
</tr>
<tr>
<td>10.4.4.3.</td>
<td>Partial deduction</td>
<td>233</td>
</tr>
</tbody>
</table>
10.4.4.3.1. General remarks 233
10.4.4.3.2. Partial deduction of cross-border trading entities 236
10.4.4.3.2.1. ECJ’s case law 236
10.4.4.3.2.2. Issues connected to the cross-border partial deduction of input taxes 239
10.4.4.3.3. The calculation of the pro rata rate of cross-border VAT trading entities 240
10.4.4.3.4. The question of calculating the pro rata rate on a worldwide or EU basis 243
10.4.4.3.4.1. General remarks 243
10.4.4.3.4.2. ECJ 12 September 2013, Case C-388/11, Crédit Lyonnais 244
10.4.4.3.4.2.1. The Advocate General’s Opinion 244
10.4.4.3.4.2.2. The ECJ’s decision 247
10.4.4.3.5. Consequences for the pro rata rate calculation and cross-border VAT grouping 248

Part Four
Interaction between VAT Grouping and the Exemption of Cost-Sharing Arrangements

Chapter 11: VAT Grouping vs. the Exemption of Cost-Sharing Arrangements 253

11.2. Personal scope 254
11.2.1. Independent group of persons 254
11.2.2. Members 254
11.3. Direct necessity of services supplied 255
11.4. Cost reimbursement 255
11.5. Distortion of competition 256
11.6. Interaction and coherence with VAT grouping 257
11.6.1. Similarities and differences 257
11.6.2. Interaction of VAT groups and cost-sharing arrangements 260
11.7. Conclusion 262
Chapter 1

VAT Groups of Companies: A Glance from the Policy Perspective

1.1. General remarks

VAT is targeted at taxing final consumption expenditure on the level of individuals. 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. 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". 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.

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.

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.


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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. 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. 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. 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. 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: 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.

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

gives the incentives for domestic legislators to introduce VAT grouping regimes in general.\(^{12}\) Indeed, there are certain other beneficial advantages for the group members which follow the basic choice of states to introduce VAT grouping:\(^{13}\) 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.\(^ {14}\) 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,\(^ {15}\) which can be connected with a joint liability of the individual VAT group members.\(^ {16}\) 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.\(^ {17}\)

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:\(^ {18}\) 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.\(^ {19}\)

\(^{12}\) 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.
\(^{18}\) 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: 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. 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. Some states use a combination of both systems, i.e. the partial single-entity treatment for VAT grouping: 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. 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.

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.
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