The End of Cost Sharing as We Know It?

Two recent Opinions of the ECJ’s AG Kokott seem to herald the end of the cost sharing exemption as we know it. In her recent Opinions in Aviva and DNB Banka AG Kokott indeed endorses a limited scope of application for the exemption provided for in article 132(1)(f) of the VAT Directive. For many VAT practitioners, and also for Member States and the European Commission, this interpretation will come as a surprise. Moreover, in an even more recent Opinion in Commission v. Germany, AG Wathelet contradicts some of AG Kokott’s findings and instead advocates a broad scope for the exemption. It is now up to the ECJ to decide, but should the ECJ concur with AG Kokott, the current use of the cost sharing exemption is up for a thorough revision.

1. Introduction

The cost sharing exemption of article 132(1)(f) of the VAT Directive is applicable to the supply of services by independent groups of persons who are carrying on an activity which is exempt from VAT, or in relation to which they are not taxable persons, for the purpose of rendering to their members the services directly necessary for the exercise of that activity, provided that the groups merely claim from their members a reimbursement of their share of the joint expenses and provided that such exemption is not likely to cause distortion of competition. The Court of Justice of the European Union (ECJ) has provided guidance on some aspects of the exemption in only three cases. Further clarification will, however, follow shortly as four cases are currently pending before the ECJ. Advocate General (AG) Kokott already delivered an Opinion in three of these cases. She addressed the Luxembourg use of the exemption in her Opinion in Commission v. Luxembourg (Case C-274/15) which was released on 6 October 2016. In her more recent Opinions in DNB Banka (Case C-326/15) and Aviva (Case C-605/15) Kokott addresses more fundamental aspects of the exemption, on which this article will focus. Where relevant, the author will also refer to the Opinion of AG Wathelet in Commission v. Germany (Case C-616/15), the fourth case on the cost sharing exemption, which was released on 5 April 2017.

2. Facts and Questions Raised in DNB Banka, Aviva and Commission v. Germany

In DNB Banka, the Latvian Regional Administrative Court (the referring court) enquired about the use of the cost sharing exemption by DNB Banka AS. This company received various services from group companies located in other EU countries in the framework of an intra-group service agreement. The remuneration charged by the group companies amounted to the cost of the services with an uplift of 5%. The latter uplift was required under transfer pricing rules. DNB Banka claimed the application of the cost sharing exemption for the intra-group services. In order to decide on the case, the referring court has sought guidance on the scope of the concept “independent group of persons” as mentioned in article 132(1)(f) of the VAT Directive. It also raised the question of whether the exemption can be combined with the transfer pricing-related uplift of 5%. Finally, the Latvian court asked whether the exemption can be used in a cross-border situation.

In Aviva the Polish Supreme Administrative Court enquired about the possible use of the exemption by a Polish group company of the Aviva Group. Aviva provides insurance services in Europe. It was considering setting up a series of shared-service centres in selected Member States of the European Union and pursuing that activity in the form of a European economic interest group (EEIG). The centres would supply services that are directly necessary for the exercise of insurance activities by members of the group (EEIG) such as HR services, financial and accounting services, IT services, adminis-
trative services, customer service facilities or new product development services. Aviva asked the Polish tax authorities to confirm that the activities of the EEIG would be exempt under the cost sharing exemption.\(^\text{11}\) This confirmation was withheld and legal proceedings followed. In this case the referring court requested clarification of the criteria for determining when there is no distortion of competition. The court also enquired whether Member States must set specific criteria in their legislation with respect to this condition. Finally, the referring court asked whether a cross-border situation would lead to different conclusions.

Based on their requests for preliminary rulings it seems that, for the referring courts, the cost sharing exemption is not restricted to taxable persons performing designated exempt activities, but is instead available for all exempt activities and non-economic activities. AG Kokott, however, now challenges this presumption.\(^\text{12}\) She indeed holds the view that the cost sharing exemption is only available for groups of taxable persons that carry out activities which are exempt in the public interest. These are the activities mentioned in article 132 of the VAT Directive. This conclusion would be based on the wording and purpose of article 132(1)(f) of the VAT Directive but also on its schematic position in the VAT Directive.

In *Commission v. Germany*\(^\text{13}\) the European Commission challenged the German cost sharing regime\(^\text{14}\) under which the use of the cost sharing exemption is restricted to the health care sector. According to the European Commission, such restriction is not compatible with the VAT Directive.

In the next sections the author successively recalls the purpose of the cost sharing exemption in the context of the VAT Directive with a special focus on the banking and insurance sectors (section 3.), addresses the questions raised by the referring courts in *DNB Banka* and *Aviva* regarding the cross-border application of the exemption (section 4.) and further discusses the conditions of absence of competition distortions (section 5.1.), the concept of independent group of persons (section 5.2.) and the delicate question of transfer pricing adjustments and consequences in the context of the cost sharing arrangement exemption (section 5.3.). Where appropriate, reference is also made to *Commission v. Germany*. Summary conclusions are offered in section 6.

### 3. The Cost Sharing Exemption in the VAT Directive

#### 3.1. The purpose of the cost sharing exemption

AG Kokott holds that article 132(1)(f) of the VAT Directive leaves unanswered the question of whether all or only some groups of persons fall within its material scope. In her view, however, an answer to that question may nonetheless be discernible from the purpose of the exemption.

An initial question is whether the wording of article 132(1)(f) of the VAT Directive does indeed leave room for interpretation. The provision refers to independent groups of persons who are carrying on an activity which is exempt from VAT or in relation to which they are not taxable persons. In the author’s view, the scope of the concept “an activity exempt from VAT” is not that ambiguous. Where a provision of the VAT Directive is aimed at designated exemptions, these exemptions are explicitly mentioned in the provision itself. Sec. for instance, articles 133, 134 and 136(a) of the VAT Directive.

However, the AG refers to previous decisions of the ECJ on the scope of VAT exemptions. For instance, *MDDP* (Case C 319-12), where the ECJ held:

> As is clear from settled case-law, the terms used to specify the exemptions in Article 132 of the VAT Directive are to be interpreted strictly. Nevertheless, the interpretation of those terms must be consistent with the objectives underlying the exemptions and must comply with the requirements of the principle of fiscal neutrality inherent in the common system of VAT. Accordingly, the requirement of strict interpretation does not mean that the terms used to specify the exemptions referred to in Article 132 must be construed in such a way as to deprive the exemptions of their intended effects (...).\(^\text{15}\)

The cost sharing exemption aims to offset the competitive disadvantage that encumbers taxable persons who share their resources. The provision ensures that an undertaking which must buy in services because, for example, it is not large enough to provide them itself is not placed at a competitive disadvantage by comparison with an undertaking which is able to have the services supplied by its own employees or as part of a VAT group. AG Kokott elucidates this mechanism with the following example:

> an undertaking which offers tax-free services must sustain the VAT payable on the inputs. Without the exemption provided for in Article 132(1)(f) of the VAT Directive, this would be the case even in circumstances where that undertaking is compelled to cooperate with other undertakings in a common structure that assumes responsibility for the activities necessary to supply those (exempt) services. If that exemption is extended to the jointly supplied inputs, the exemption applicable to the output will cover the same added value as it would in the case of a competitor procuring the input from its own employees. Thus, the final consumer benefits from the exemption even where a group of undertakings operating under a tax exemption provides certain inputs that have directly contributed to the exempt output supplied to him.\(^\text{16}\)

AG Kokott concludes that the purpose of the cost sharing exemption is to extend the scope of the exemption applicable to the output of the relevant group of persons. The exemption for the output is extended so that the jointly supplied input is included. This implies that the purpose of the cost sharing exemption is determined by the purpose of the exemption used for the output activities.

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11. Under art. 43 (1)(21) Polish Law on VAT, which was based on art. 132(1)(f) VAT Directive.
12. Opinion in *DNB Banka* (C-326/15), point 46. Opinion in *Aviva* (C-605/15), points 19 to 35.
14. In Germany, the exemption from VAT laid down by art. 132(1)(f) VAT Directive is transposed in para. 4(14) Umsatzsteuergesetz (Law on turnover tax).
15. PL: ECJ, 28 Nov. 2013, Case C-319/12, Minister of Finance v. MDDP Sp. z o.o., Akademia Biznesu, Sp. komandytowa, ECJ Case Law IBFD.
This exercise is then applied to Aviva and DNB Banka, where the relevant output activities consisted of exempt insurance activities and exempt financial activities, respectively. According to AG Kokott, insurance services such as those performed by Aviva are exempt from VAT because they are already subject to insurance tax. The purpose of the insurance exemption is to prevent the concurrent levying of multiple taxes. According to the AG, an exemption of input services (the services performed by the EEIG) is therefore not essential for the purposes of avoiding double taxation on the output activities (the insurance services of Aviva). From this, the AG concludes that there is no reason to apply the cost sharing exemption to the activities of the EEIG. As regards the primary purpose of the exemption of banking services such as those performed by DNB Banka, it is to alleviate the difficulties connected with determining the taxable amount and the amount of VAT deductible. This purpose is not served by exempting (non-financial) input services for these banking services. Therefore, AG Kokott again claims here that applying the cost sharing exemption would be contrary to its purpose.

In the author’s view, the AG’s line of thought on how to ascertain the scope of the cost sharing exemption is not derived from earlier decisions of the ECJ on this topic. In Taksatorringen (Case C-8/01), for example, the ECJ did not have any second thoughts on the use of the cost sharing exemption for services performed to an association of insurance companies. The ECJ held that “the grant of VAT exemption under that provision [the cost sharing exemption] to an association such as that in issue in the main proceedings and which satisfies all of the other conditions of that provision must be refused if there is a genuine risk that the exemption may by itself, immediately or in the future, give rise to distortions of competition”. In his Opinion in the Taksatorringen case, AG Mischo also did not question the use of the cost sharing exemption for services directly necessary for the exercise of insurance activities.

According to AG Kokott in Aviva, in Taksatorringen the ECJ was only concerned with the interpretation of “distortion of competition” and the ECJ’s answer was “clearly confined to that issue alone”. However, in the author’s view, this would imply that the ECJ turned a blind eye to a crucial aspect of the exemption, which is rather unlikely. Interestingly enough, in his recent Opinion in Commission v. Germany, AG Wathelet holds that the ECJ did recognize in Taksatorringen that insurance transactions came under the exemption for cost sharing. AG Wathelet concluded that the ECJ had thus already extended the exemption to activities which do not have a medical or social objective.

Another concern with the “extension of the output exemption” approach of AG Kokott is that the cost sharing exemption may also relate to services directly necessary for the exercise of the members’ non-taxable output activities. In that case, there is no exemption to be extended. The author does not see how the proposed mechanism could then function. Perhaps this mechanism was not intended by the legislature in the first place.

3.2. The context of the cost sharing exemption

In CILFIT (Case 283/81), the ECJ ruled that: “every provision of Community law must be placed in its context and interpreted in the light of the provisions of Community law as a whole, regard being had to the objectives thereof and to its state of evolution at the date on which the provision in question is to be applied.” When looking at the context of the cost sharing exemption, AG Kokott notes in her Opinion in Aviva that article 132(1)(i) of the VAT Directive is not a general provision applicable to all exemptions in the same way as article 134 of the VAT Directive. Instead, the cost sharing exemption is contained in Title IX of the VAT Directive, under chapter 2 “Exemptions for certain activities in the public interest”. These activities are intended to relieve consumers of those and other services of the burden of VAT on public-interest grounds, be it because the services are typically supplied to persons in need (for example, subparagraph (g) – social welfare), because the costs of vital medical treatment are not taxed (for example, subparagraphs (b) and (c)), or in order to make the education necessary to a society easier to afford (for example, subparagraphs (i) and (j)).

AG Kokott further holds that the drafting history of the provision does not support the inference that groups of banks or insurance companies were also to be included. She claims that activities of banks or insurance companies do not serve the public interest and should not be facilitated by allowing the cost sharing exemption. In this respect, the AG refers to the decision of the ECJ in TMD (Case C-412/15). This case revolved around the question of whether the supply of plasma as a component for blood fell under the “public interest” exemption for the supply of human organs, blood and milk. The ECJ held that the exemption only applied to supplies serving the public interest, which implied that the exemption applied to the supply of plasma used directly for health care or for therapeutic purposes. The exemption did not include the supply of plasma for industrial production. In her Opinion in Aviva, AG Kokott seems to claim that if this TMD criterion is applied to the cost sharing exemption, services for banking and insurance activities are excluded. However, in the author’s view, TMD does not support the latter line of thought. Article 132(1)(d) of the VAT Directive exempts the supply of human blood. Plasma is a component of human blood. It is a good with a dual use. It can be used in the public interest (for health care or therapeutic purposes), in which case the supply should be equated with the supply of blood and the exemption...
should apply. When the plasma is supplied for industrial production, this rationale does not apply. In that case the exemption should be withheld. The public interest only plays a role because plasma as such is not included in the exemption. This situation is not comparable to the cost sharing exemption. Here, there is no reason to involve the public interest as the wording of the legal provision is clear. There is nothing in the wording of the provision to exclude its application to commercial services. Also, in Hoffmann (Case C-144/00) the ECJ held that “the heading of Article 13(A) of the Sixth Directive [now Article 132 of the VAT Directive] the wording of which is ‘Exemptions for certain activities in the public interest’, does not, of itself, entail restrictions on the possibilities of exemption provided for by that provision.” In this procedure, the UK government took the position that the heading of article 13A of the Sixth Directive indicated that the exemptions provided for by that provision must be restricted to activities in the public interest: only activities carried on in the public interest are exempted and not those carried on solely for profit. The ECJ did not agree and noted that: “The possible restrictions on the benefit of the exemptions provided for by Article 13A of the Sixth Directive may be imposed... only in the context of the application of paragraph 2 of that provision.”

The ECJ holds that article 132 aims to exempt from VAT certain activities in the public interest with a view to facilitating access to certain services and the supply of certain goods by avoiding the increased costs that would result if they were subject to VAT. A cost sharing exemption facilitates the use of economies of scale and thus supports medium and small (exempt) businesses. It also facilitates the use of economies of scale by public authorities performing non-taxable activities. Facilitating the use of economies of scale is one of the cornerstones of the internal market, so how can such a facility not be in the public interest?

Summing up, in the author's view, the fact that article 132(1)(f) of the VAT Directive also exempts services for non-taxable output does not sit well with the line of reasoning followed by AG Kokott. If indeed the cost sharing exemption is to be limited to exemptions in the public interest, why didn’t the legislature not refer to these specific exemptions in the wording of article 132(1)(f) of the VAT Directive? A literal interpretation of this provision makes sense.

3.3. The specific case of the banking and insurance sector

As a separate argument, AG Kokott claims that until a few years ago, the prevailing view within the European Commission was that the cost sharing exemption did not include the banking and insurance sectors, but that the exemption should be extended by the legislature to include these sectors. AG Kokott here refers to the proposal on the VAT treatment of insurance and financial services which the European Commission tabled in 2008. This proposal contained a provision for a cost sharing exemption especially aimed at the insurance and banking sectors. However, the proposal was never adopted by the Council. According to AG Kokott, the decision by the legislature not to adopt the proposal cannot be reversed by a broad interpretation of the exemption as endorsed by the European Commission in Aviva and DNB Banka. However, the author notes that it remains to be seen whether the European Commission did indeed extend to the scope of the cost sharing provision in this respect. In the Impact Assessment of its 2008 proposal, the European Commission assumes that the current cost sharing provision is available for financial services and insurance. The European Commission states: “Since 1977, smaller insurance companies have been among the most consistent users of cost sharing arrangements where this is permitted. Access to Article 132(f) allows them to do that without creating a fresh VAT charge”. The European Commission further states that a revised provision for the cost sharing exemption needed to ensure its consistent application in all Member States. According to the European Commission, this should also be the occasion to deal with some of its less clear aspects which have been adduced as reasons for less than full implementation.

3.4. The different view of AG Wathelet

The above views of AG Kokott regarding the scope of the cost sharing exemption are not shared by her colleague, AG Wathelet. In his Opinion in Commission v. Germany, released five weeks after the Opinions of AG Kokott in DNB Banka and Aviva, AG Wathelet states that the exemption of article 132(1)(f) of the VAT Directive applies to all economic sectors. In his view, the mere fact that the chapter to which article 132 of the VAT Directive belongs is entitled “Exemptions for certain activities in the public interest” does not detract from the uniformity of its wording. AG Wathelet further holds that the title of a chapter

27. DE: ECJ, 3 Apr. 2003, Case C-144/00, criminal proceedings v. Matthias Hoffmann, para. 37. ECLI:EU:C:2003:192. ECJ Case Law IBFD.
29. TMD (C-412/15), para. 30.
33. Opinion in Commission v. Germany, (C-616/15), point 96.
34. In this respect, AG Wathelet (Opinion in Commission v. Germany (C-616/15), point 104) refers to DE: ECJ, 1 Mar. 2016, Joined Cases

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is merely indicative for the purposes of the interpretation of the provisions contained therein. According to AG Wathelet, the exemption laid down in article 132 (1)(f) of the VAT Directive may not be restricted to activities in the public interest (or a fortiori to the health sector as is the case in Germany), despite, as he notes “the imperfections in the wording of the VAT Directive.”

AG Wathelet further notes that the German restriction of the cost sharing exemption to the health sector can also not be justified by a genuine and general risk of distortion of competition. “Article 132(1)(f) of the VAT Directive requires an examination in each individual case whether there is a risk of distortion of competition”, as he put it. All in all, AG Wathelet concludes that Germany infringes EU law with its limited interpretation of the cost sharing exemption.

4. Cost Sharing Exemption and Cross-Border Application

4.1. Introduction

Should the ECJ endorse AG Wathelet’s Opinion and deviate from AG Kokott’s conclusion, and decide that the cost sharing exemption is available for insurance or banking services, then it needs to be decided whether the cost sharing exemption also covers services supplied by a cross-border group to its members established in other Member States (or third countries). This question also arises in cases where the group itself is established in a third country. In her Opinion in Aviva AG Kokott concludes that a cross-border use of the cost sharing exemption is not possible. In DNB Banka she reiterates this position.

In her Opinion in Aviva, AG Kokott notes that, at first sight, the wording of article 132(1)(f) of the VAT Directive contains no restriction requiring the members of the group and the group itself to be established in the territory of a single Member State. However, she then elaborates six arguments to come to the conclusion that a cross-border use of the exemption is not possible:

- the provision’s drafting history;
- the scheme of the exemptions;
- inconsistency with the VAT grouping facility;
- problems with ascertaining distortion of competition;
- no conflict with fundamental freedoms when disallowing cross-border use; and
- allowing cross-border use facilitates VAT-saving structures.

These arguments are successively addressed below.

4.2. The drafting history of the cost sharing exemption

The first argument of AG Kokott is that the cost sharing exemption was initially contained in article 13 of the Sixth Directive. As was apparent from its heading, the latter provision applied to “exemptions within the territory of the country”. This heading disappeared when the Sixth Directive was replaced by the VAT Directive, but no material change of the exemption itself was intended. The current exemption would therefore still be restricted to “exemptions within the territory of the country”. According to AG Kokott, this would support the assumption that the exemption applies only to supplies made by groups or group members which are themselves established in the national territory.

The author does not concur with these findings. In his view, the cost sharing exemption applies to certain services, provided that all conditions are met. Following the place of supply rules, such services are attributed to one country (either the country of the group or the country of its members). The services are then deemed to be performed in that country and may be subject to an “exemption within the territory of the country”. Also, the territorial limitation of the cost sharing exemption as proposed by AG Kokott implies that exemptions are withheld for all cross-border services (as the heading “exemptions within the territory of the country” related to all exemptions mentioned in article 13 of the Sixth Directive). This included not only the “exemptions for certain activities in the public interest” but also “other exemptions” that are now contained in articles 135 to 137 of the VAT Directive.

4.3. The scheme of the exemptions

AG Kokott also finds support for her restrictive interpretation of the cost sharing exemption (no cross-border use) in the fact that chapters 4 to 8 and 10 of the VAT Directive contain the special exemptions applicable to cross-border transactions. In particular, she notes, cross-border (transport) services are explicitly dealt with in chapter 7. Again, this reasoning implies that all other cross-border services cannot be VAT exempt. The author considers it unlikely that the ECJ will adhere to this view, as nothing in the VAT Directive suggests that such a regime was ever intended.

4.4. Inconsistency with VAT grouping facility

According to AG Kokott, a broad (cross-border) interpretation of the costs sharing exemption would give rise to an inconsistency with the VAT grouping provisions of article 11 of the VAT Directive. She refers to the example in which two undertakings form a group in such a way as to give one of them a majority share in the group. In this case, article 11 of the VAT Directive would not apply to any cross-border services supplied by that group to its members. On the other hand, the cost sharing exemption would be applicable to such cross-border services. In AG Kokott’s view, this implies that the VAT exemption created under the
provision laying down less stringent requirements with respect to the nature of the group would operate across borders, but the one created under the provisions imposing stricter conditions would not. According to her, that inconsistency can be resolved only if the effects of the cost sharing exemption are confined to one Member State.\textsuperscript{41}

The author notes, however, that the regime for VAT grouping and the regime for the cost sharing exemption are fundamentally different. The VAT grouping regime is optional. It then makes sense to limit its working to one Member State, as explicitly provided for in article 11 of the VAT Directive. The cost sharing exemption, on the other hand, is a mandatory provision, which all Member States should apply in the same manner. Then a reason for restricting its scope to one Member State does not exist. Such territorial restriction is also not included in the wording of the provision in the VAT Directive.

4.5. Evaluating distortion of competition

According to AG Kokott, the fact that an exemption may not lead to a distortion of competition indicates that the cost sharing exemption should be confined to a single Member State. In this respect, the AG notes that the ECJ held in \textit{Isle of Wight Council and others}\textsuperscript{42} that “distortion of competition” in connection with article 13 of the VAT Directive is not to be determined by reference to any local market in particular. The ECJ argued that the monitoring of a multitude of local markets assumes a systematic re-evaluation of often complex analyses of the conditions of competition on these markets, the determination of which may prove particularly difficult since the markets’ demarcation does not necessarily coincide with the areas over which the local authorities exercise their powers. That situation is therefore likely to jeopardize the principles of fiscal neutrality and legal certainty.

The AG refers to the fact that differences between markets increase in cross-border situations. A possible distortion of competition (but also the other conditions for the exemption) must then be reviewed in both the Member State of the group and the Member State of the group members. According to AG Kokott, the risk of contradictory decisions in such circumstances is undeniable. She also claims that mutual assistance between Member States did not exist when the legislation was enacted and that nowadays, the EU mutual assistance system certainly does not solve the problem of contradictory decisions involving third countries.\textsuperscript{43}

The author questions, however, whether the review of the markets is that relevant for the possible use of the cost sharing exemption. In \textit{Isle of Wight Council and others}, the ECJ concluded that it was the nature of the activity, and not the local conditions of competition, which has to be taken into account to assess the likelihood of distortions of competition. In the author’s view, this implies that market analyses are \textit{not} required and that cross-border supplies do not constitute special problems. Moreover, it is doubtful whether the mere risk of contradictory decisions from Member States is sufficient reason to deviate from the clear wording of provisions in the VAT Directive.

4.6. No conflict with fundamental freedoms when disallowing cross-border exemption

As a separate argument for disallowing the cross-border use of the exemption, AG Kokott holds that her interpretation of the exemption does not come into conflict with the fundamental freedoms. The AG claims that a restriction of the fundamental freedoms can be justified only by overriding reasons in the public interest. In her view, excluding the exemption for cross-border cost sharing would be justified by the need to preserve the allocation of powers between Member States and the need to guarantee the effectiveness of fiscal supervision. The effect of the cost sharing exemption under article 132(1)(f) of the VAT Directive could therefore not be extended to a cross-border group, because this may lead to a situation in which the VAT revenue in one Member State would be affected by another Member State.\textsuperscript{44}

The author notes that the risk as indicated by AG Kokott materializes when Member States have deviating Opinions on whether the conditions for the cost sharing exemption are met. Such risk is, however, inherent to all cross-border supplies. The fact that EU law is not applied uniformly, does not imply that the cross-border use of a facility that clearly has a function in the internal market should be refused.

4.7. A cross-border exemption facilitates VAT-saving structures

Finally, AG Kokott holds that a broad interpretation of the cost sharing exemption, allowing it for cross-border structures, facilitates VAT-saving structures. She claims that tax optimization is especially available for groups of companies that operate globally. The latter would simply have to form, with its EU affiliates, a cost sharing group, established in a third country where there is no VAT (such as the United States), purchase services from EU providers without VAT and then provide these services under the exemption to its EU group members.\textsuperscript{45} Within the European Union, cost sharing groups will be established in the country with the lowest rate of VAT in order to best minimize the burden of input VAT. According to the AG, it can hardly be assumed that the legislature intended to tolerate such an outcome of the cost sharing provision.

In this respect, AG Kokott refers to the fact that a similar problem in connection with mail order businesses prompted the legislature to include in article 34 of the VAT Directive a threshold to prevent all mail order businesses from establishing themselves in the country with

\textsuperscript{41} Id., points 46 to 49.

\textsuperscript{42} UK: ECI, 16 Sept. 2008, Case C-288/07, The Commissioners of Her Majesty’s Revenue & Customs v. Isle of Wight Council, Mid-Suffolk District Council, South Tyneside Metropolitan Borough Council, West Berkshire District Council, ECLI:EU:C:2008:505, ECJ Case Law IBFD.

\textsuperscript{43} Opinion in Arriva (C-465/15), points 50 to 56.

\textsuperscript{44} Id., points 57 to 61.

\textsuperscript{45} See also J. Swinkels, VAT-Saving Solutions and Abuse of Law, 18 Intl. VAT Monitor 3, sec. 4.4.3. (2007), Journals IBFD.
the lowest VAT rate. In the author’s view, however, the latter fact does not seem to support the AG’s view that cost sharing cannot be used across borders. Instead, it demonstrates that the legislature counters possible VAT losses with specific provisions in the VAT Directive. Also, the author believes that VAT leakage can be countered with a strict interpretation of the other conditions of the cost sharing exemption, instead of flatly refusing this facility for cross-border situations.

5. Further Issues

5.1. How to interpret distortion of competition?

The referring court in Aviva asks what criteria should be applied in assessing whether the condition of distortion of competition is fulfilled. This question is only relevant when the ECJ does not follow the “strict” interpretation of the exemption as propagated by its AG. For that situation, AG Kokott provides some guidance on how to interpret the competition clause. In her view, this condition asks for a restrictive interpretation, the starting point of which can be found in Taksatorringen, where the ECJ found it relevant whether a group could be certain of keeping its members’ custom even if there is no exemption.

AG Kokott holds that the distortion of competition criterion serves to avoid abuse, and that the exemption must not be applied inappropriately. She then mentions some examples for the latter. For instance, when a group supplies the same services for consideration to non-members and is to that extent, by exploiting effects of synergy, operating on the market. Or when the group does not supply any services tailored to the specific needs of its members, with the result that such services could just as easily be offered by others too. She further notes that article 132(1)(f), in conjunction with article 131, of the VAT Directive does not require that the national law prescribes any criteria or procedures with respect to compliance with the condition that there must be no distortion of competition. The cost sharing exemption of article 132(1)(f) of the VAT Directive is sufficiently clear and unconditional and, therefore, directly applicable.

5.2. How to define “independent group of persons”?

In DNB Banka, the referring court also sought guidance on the scope of the concept “independent group of persons” as mentioned in article 132(1)(f) of the VAT Directive. Here a company received services from group companies located in other EU Member States. The question is whether these groups of related undertakings can qualify as an “independent group of persons” within the meaning of the cost sharing exemption of article 132(1)(f) of the VAT Directive, in which case the service received could be exempt.

In her Opinion in this case, AG Kokott considers that the cost sharing exemption is applicable to the supply of services by the “independent group of persons” to its members. This implies that the “independent group of persons” acts as “a taxable person acting as such”; otherwise no VAT-relevant supply would occur. Such an independent group does not have to be a legal person. However, a group of several independent companies, based solely on shareholdings among them, does not act as a taxable person and can therefore not qualify as an “independent group of persons” that can use the exemption.

5.3. What are the effects of a cost uplift for transfer pricing purposes?

In DNB Banka, transfer pricing guidelines required a cost uplift of 5%. The referring court raised the question of whether under these circumstances the cost sharing exemption can be applied. To this question, AG Kokott provides a straightforward answer. Under article 132(1)(f) of the VAT Directive, the supply of services by a group is exempted only under the condition that the group “merely claim[s] from [its] members exact reimbursement of their share of the joint expenses”. This condition is not met when a cost uplift is applied. This is also the case when such flat-rate cost uplift is required under the legislation on direct taxation.

This conclusion will not come as a surprise. A tension between transfer pricing guidelines, and the condition that an exact reimbursement of the share of the joint expenses must be claimed, has already been acknowledged by the European Commission. In this respect, the 2008 proposal contained a specific provision to disregard transfer pricing adjustments when looking at the reimbursement condition. Unfortunately, the European Commission did not provide any further clarification on this part of its proposal.

6. Conclusion

In her Opinions in Aviva and DNB Banka, AG Kokott goes to great lengths to limit the scope of the cost sharing exemption. Banks and insurance companies are excluded, as is the cross-border use of the provision. Such strict interpretation does not follow from the wording of the applicable provision in the VAT Directive. It would also be new for most Member States and the European Commission. Furthermore, the Opinion of AG Wathelet in Commission v. Germany demonstrates that also within the ECJ, AG Kokott’s views are not undisputed. This does not alter the fact that the current cost sharing exemption could use some clarification on certain points. However, the ECJ should do that without effectively shutting down most of its current use.

46. European Commission Staff Working Document, supra n. 32.
47. Taksatorringen (C-8/01), para. 39.

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