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VAT EXPERT GROUP

VEG N^o 070

Draft paper on topic for discussion

**Meaning of "financial, economic and organisational links" among VAT
group members**

Introduction

One of the agreed short term actions in the Dublin Fiscalis was for the Commission to look at Article 11 of the VAT Directive and explore whether the VAT Grouping preconditions can be further clarified to ensure a more consistent application across the EU and increase legal certainty and efficiency. It was agreed in Dublin that the Commission would involve the GFV and VEG in its work.

The Dublin Fiscalis showed, it is important to look at this topic from various perspectives and to explore short, medium-term and long-term deliverables in order to improve the current situation for Member States and business building on best practices - being visionary and realistic at the same time, in particular in cross-border situations.

The VEG thanks the Commission for its Paper and the opportunity to provide our technical and practical feedback based on our collective experience as academics, as lawyers, as tax advisors working in business or advising businesses across the EU.

Background

VAT grouping has been introduced into the EU VAT system in the second VAT Directive when the EU only had 6 Members. It was requested by the Netherlands and agreed to by the other 5 Member States. It is included in the current VAT Directive¹ as an option for Member States leaving the implementation to each of them.

The provision has remained unchanged and reads as follows in the current EU VAT Directive²:

Article 11

*“After consulting the advisory committee on value added tax (hereafter, the “VAT Committee”), each Member State **may** regard as a single taxable person any persons established in the territory of that Member State who, while legally independent, **are closely bound to one another by financial, economic and organizational links.***

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”

The rationale behind VAT Grouping is to provide Member States a “tool“ to combat abuse and fraud and to provide administrative simplification to the taxable persons. Next to that the joint and several liability of the members of the VAT group protects the interests of the “Exchequer“ and of the tax administrations.

This is one of the main drivers for Member States to introduce VAT grouping next to providing administrative simplification to taxable persons reducing their cost of compliance and to manage risks when billing intra-group. From a tax authority perspective, the cost of collection (only one VAT return to be processed instead of multiple) and enforcement also reduces, as a “group“ is now registered and needs to be audited with a single point of contact, being the representative of the VAT group.

¹ Second Council Directive 67/228/EEC of 11 April 1967 on the harmonization of legislation of Member States concerning turnover taxes Structure and procedures for application of the common system of value added tax, OJ L303, 14.4.67, page 67, Annex A.2, <https://publications.europa.eu/en/publication-detail/-/publication/99ab67a1-f672-4605-8a30-c93cf82973de/language-en>.

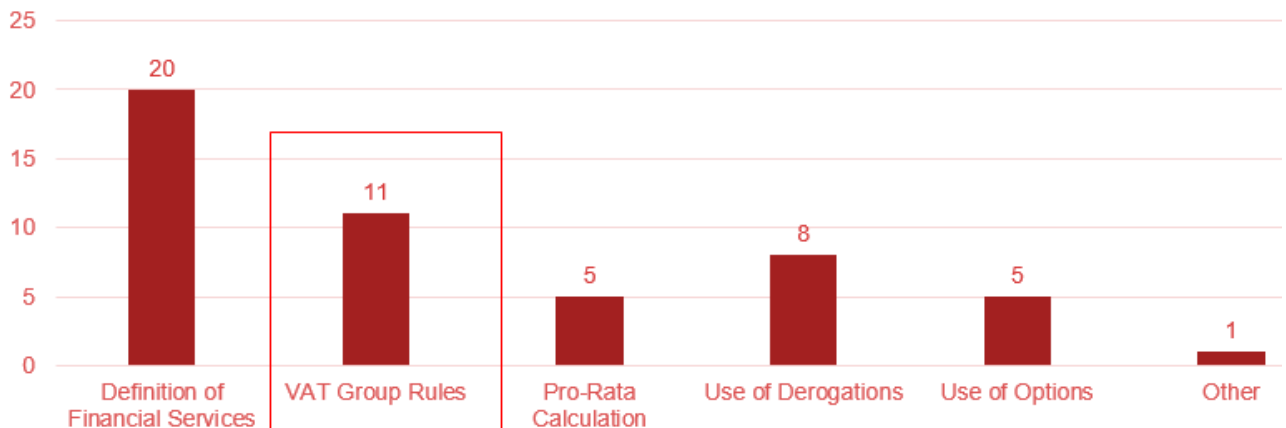
² Council Directive 2006/112/EC of 28 November 2006 on the common system of value added tax, OJ L347, 11.12.2006, page 1, <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2006:347:0001:0118:en:PDF>.

This is one of the main reasons why the tax authorities are in favor of VAT grouping. All “activities“ of an entire group are - without multiple interactions and audits at each company - transparent to the tax authorities through this single point of entry.

Reducing the impact of VAT on the cash flow of businesses where one member of a company group is in a payable VAT position whilst another member of a group claims a refund, has become another major advantage of VAT grouping both for business and tax administrations, particularly as some Member States were and are still struggling with an efficient and timely operating VAT refund system process.

In addition, many Member States who did introduce VAT Grouping also did so in order to improve the competitiveness of their country both within the EU and from a global perspective. The competitiveness is improved not only by reducing the cost of compliance and the risk of doing business as no VAT risks occur for intra-group transactions within the same Member State. An important element is also to limit the cascading of non-deductible VAT in order to keep in or attract industries impacted to their Member State.

VAT Grouping is one of the most important VAT factors to attract and retain financial services operators and outsourcers



Source: Study to increase the understanding of the economic effects of the VAT exemption for financial and insurance services, PwC, Report to the European Commission - September 2006

This is especially targeted at financial and insurance industry where the use of technology is key and where outsourcing is the norm. Outsourcing within a VAT group is a better and viable option compared to outsourcing and offshoring to low-cost non-EU jurisdictions. Indeed from a PwC Study made for the EU Commission in 2006, it appears that VAT grouping is one of the most important VAT factors to attract and retain financial services operators³. Further VAT groups become more important within the financial and insurance industry as recent CJEU case law⁴

³ Study to increase the understanding of the economic effects of the VAT exemption for financial and insurance services, PwC, Report to the European Commission, September 2006.

⁴ CJEU, C-605/15 (Aviva Towarzystwo Ubezpieczeń na Życie S.A. w Warszawie), 21 September 2017, CJEU C-326/15 (DNB Banka AS), 21 September 2017, CJEU C- 616/15 (Commission against Germany), 21 September 2017.

limits cost-sharing associations to public interest and social sector (whereas for VAT grouping there is, in principle, no sector limitation).

Introduction of VAT Grouping by the Member States and number of VAT groups

The Netherlands and Germany were the first Member States to introduce VAT grouping in the EU VAT system.

As the figure shows VAT grouping is currently implemented in 16 Member States. Italy will introduce VAT grouping as from 2018 onwards in its law allowing to have VAT groups to be created as from 2019.

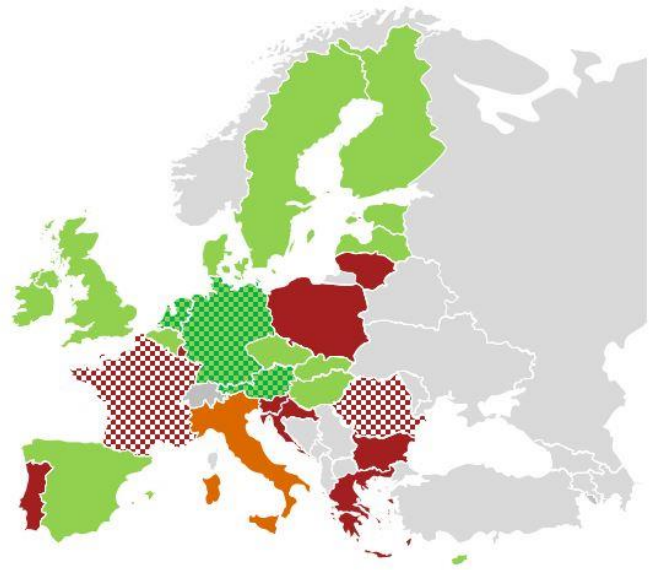
The vast majority of Member States who have introduced VAT grouping leave the decision to group or not to group to the businesses. Only 3 Member States, being Austria, Germany and the Netherlands make it mandatory for businesses when the criteria are fulfilled (with no option to waive).

VAT grouping is different from a VAT consolidation payment scheme. This scheme is introduced for instance in Italy, Malta, Romania and France⁵. In case of VAT consolidation, the parent company of a group files a consolidated periodical VAT return. This consolidated VAT return is an aggregation of all periodical VAT returns from the entities which are part of the business structure. As a consequence, the VAT return position of “group companies” can be offset and only the balance will be paid to or refunded by the Member State. It is a “cash management” tool. However, under a consolidated VAT payment scheme, the group companies are, contrary to the VAT Grouping, not “a single” taxable person and are not jointly and severally liable for VAT towards the Member State.

Overview of VAT grouping in the EU

⁵ CJEU, C-162/07 (Amplifiscientifica Srl, Amplifin SpA), 22 may 2008 – on the basis of authorization for a derogation (article 395 of the current VAT Directive).

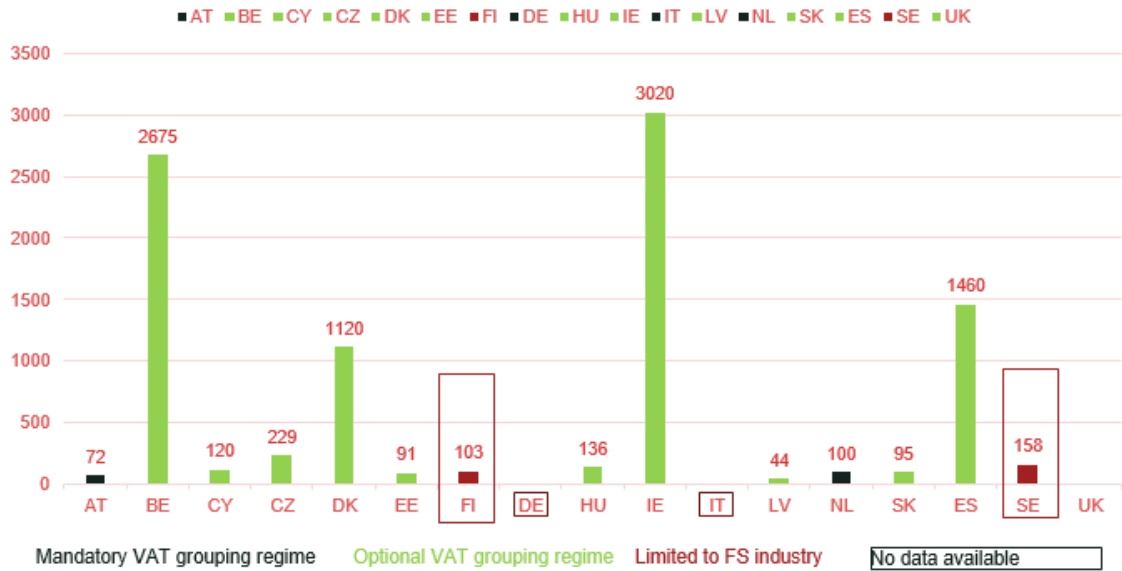
- Member States with VAT grouping (13)
- Member States with Mandatory VAT grouping (3)
- VAT grouping as from 2019 (Optional VAT grouping but existing VAT consolidation model will remain) (1)
- Member States with no VAT grouping (8)
- Member States with no VAT grouping but with VAT consolidation model (3)



Source: Network Survey, PwC ITX Financial Services Network, October 2017

Two Member States, being Sweden and Finland, limit the scope of application of VAT grouping to the financial services and insurance industry. In Finland, companies performing mainly taxable services can also be members of a Finnish VAT group but only if the company is under the control of a member of the VAT group which either supplies mainly financial or insurance services exempt from VAT or is a holding company of a financial or insurance group. Under the Swedish VAT Act, taxable persons operating under the supervision of the Swedish Financial Services Authority (i.e. within the finance and insurance sector) or companies providing majority of their supplies (approx. 70-80 %) to the before mentioned taxable persons may be grouped. In the other Member States, VAT grouping applies cross-industry.

The figure below shows that the uptake in Member States where the system is not mandatory and applying cross-industry is high. This underlines VAT grouping is important to businesses and is meeting their needs notwithstanding the joint and several liability and the full transparency. On the basis of those data one can conclude that VAT grouping is a win-win for both stakeholders, the government and businesses.



Source: [Fiscalis Seminar on Modernising of VAT Groups](#), 12-14 September 2016, Dublin

Experiences with VAT grouping

The Netherlands

The concept of VAT grouping has existed in the Netherlands from 1969, so for almost five decades, and works very well. The provision on VAT grouping can be found in article 11 of the *Wet op de Omzetbelasting 1968* (Dutch Turnover Tax Act). Though there have been a few court cases, for instance about the foundations and the CJEU case *Van der Steen*⁶, both businesses and tax administration are very happy with this concept. As far as we know, there are no major cases known of abuse or fraud with VAT groups.

Belgium

Belgium has introduced an optional VAT grouping scheme about a decade ago. The provision on VAT grouping can be found in article 4, §2 of the Belgian VAT Code. Since then the uptake has been important cross-industry. Nor the legislation nor the administrative guidance had to be changed since then. No disputes or litigation occurred to our knowledge. A specialized unit has been put in place for handling the VAT grouping requests and to perform the audits of VAT groups.

The UK

The UK applies a voluntary VAT grouping regime which treats the VAT group as a single taxable person and considers the whole legal entity as a member of the VAT group (i.e. including headquarters or branch located abroad). Regarding eligibility, the VAT grouping is limited to “bodies corporate”, which includes mostly companies and limited liability partnerships.

To ensure the entities are “closely bound by financial, economic and organisational links”, the UK applies a control test, where all members of the group are controlled either by one member of the group, or a single other “person” who is not one of the members of the group. In summary, it is a “vertical grouping” with a single controlling body at the top.

⁶ CJEU, C-355/06 (*Van der Steen v Inspecteur van de Belastingdienst Utrecht-Gooi/kantoor Utrecht*), 18 October 2007.

The eligibility test was recently consulted on, focusing on potential expansion to non-legal entities following Larentia & Minerva judgement⁷, with no clear conclusion on any legal changes, however further guidance is considered to improve clarity of current rules.

Germany

The concept of VAT grouping exists in Germany since 1934, at that point in time Germany operated a turnover tax without input VAT deduction. The concept was also introduced in the later implemented EU based VAT system in Germany. VAT grouping is a mandatory system in Germany, so companies that fulfil the preconditions (financial, economic and organizational link) must form a VAT group. Until about 15 years ago, there were no major issues with operating VAT groups in practice, and the tax authorities applied a holistic approach when applying the preconditions. Unfortunately, a variety of court cases in Germany and their focus on the links (particularly on the organizational link), have since created a big legal uncertainty both for business and tax administrations through an overly formalistic approach developed by the local courts in Germany. Therefore, the work taken up by the European Commission to further clarify the “meaning of financial, economic, and organizational links among VAT group members” is highly welcomed by all stakeholders in Germany. Making VAT grouping optional for business as the majority of Member States do, is also a currently discussed hot topic in Germany, which many stakeholders would support given the best practices in other countries.

Spain

VAT grouping was introduced in Spain as from 1 January 2008. The regime is twofold: a mere VAT consolidation regime (the so-called basic level) and, optionally, a VAT grouping (“advanced level”). Although the latter does not respond to the idea of a single taxable person, it tries to achieve an analogous economic outcome. The regime is voluntary so that even within a particular group, some entities may opt for its application while others remain out of the group. However, the dominant entity must always be part of the group. The three links must be met. The definition of the links is based on the Commission’s Communication of 2009. A rebuttable presumption is established by virtue of which the organizational and economic links are deemed met if the financial link exists. Since its introduction it has been widely applied, with no major controversies having been brought to the administrative courts.

VAT grouping is a VAT concept

VAT grouping is a “stand alone” VAT concept. It allows to group taxable and non-taxable persons⁸ independent of the legal form, the business set-up or the commercial and economic reality.

Note that following several CJEU cases⁹, article 11 of the VAT Directive merely refers to “persons” being able to join a VAT group, which covers both taxable and non-taxable persons.

⁷ CJEU, C-108/14 (Beteiligungsgesellschaft Larentia + Minerva mbH & Co. KG), 16 July 2015.

⁸ CJEU, C-60/90 (Polysar Investments Netherlands BV), 20 June 1991, C-155/94 (Welcome Trust Ltd), 20 June 1996, C-80/95 (Harnas & Helm), 6 February 1997, C-142/99 (Floridienne and Berginvest), 14 November 2000.

⁹ CJEU, C-65/11 (European Commission v. Kingdom of the Netherlands), 25 April 2013; CJEU, C-74/11 (European Commission v. Finland), 25 April 2013; CJEU, C-85/11 (European Commission v. Ireland), 3 April 2013; CJEU, C-86/11 (European Commission v. United Kingdom of Great Britain and Northern Ireland), 25 April 2013; CJEU, C-95/11, (European Commission v. Kingdom of Denmark), 25 April 2013; CJEU, C-109/11 (European Commission v. Czech republic), 25 April 2013.

VAT grouping does justice to both neutrality of legal form and economic reality. It does not make any difference whether the “person“ is incorporated as a single legal person for business or commercial law reasons, or as several legal persons.

Conditions to group: under the VAT Directive none of the links prevail requiring a holistic approach when applying this requirement

Article 11 of the VAT Directive provides that Member States **may** “*regard as a single taxable person any persons established in the territory of that Member State who, while legally independent, are closely bound to one another by financial, economic and organizational links*”. The reference to financial, economic and organizational links has been part of the provision as from the beginning.

- The **financial link** is commonly “defined” as the direct (or indirect) participation in the capital shares or in the voting rights. In practice, the participation ranges from at least 10% (Belgium) to 75% (Austria). The majority of the Member States apply a threshold of more than 50% in the capital shares to determine the financial link.
- The **economic link** is commonly “defined” as economic cooperation, being the principal activity of the members is of the same nature, providing similar or complementary business activities or carrying out activities that benefit, fully or substantially, the other group members – it is about promoting the group’s economic activity as often indicated in the group’s parent articles of association.
- The **organizational link** is commonly “defined” as a shared, or partially shared, management structure between group members, based on and following company and common decision making guidelines, standards and policies, monitored and controlled by internal audit.

The VAT Directive is referring to the three above binding factors between the taxable and non-taxable persons whilst legally independent becoming a single taxable person. There is a need for a close link.

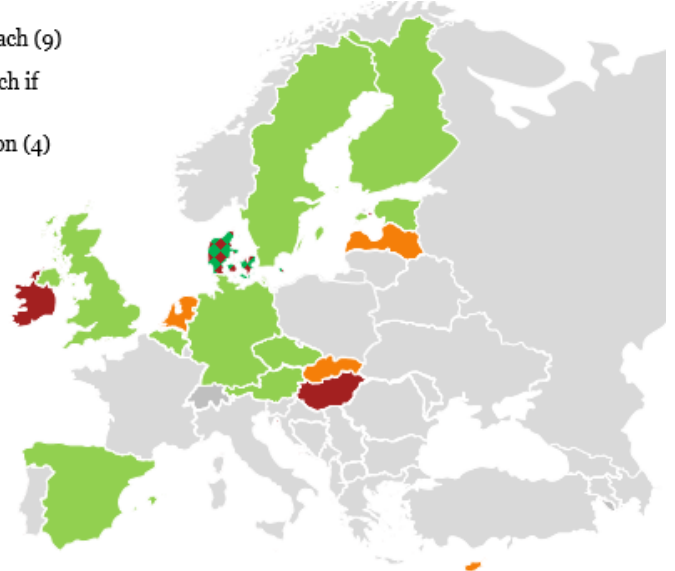
The links need to exist simultaneously but the text of the VAT Directive is not saying that one link is more important than the other and therefore prevails. The key term here is “**closely bound to one another**”. The three links should be applied in a flexible way based on **a holistic approach**, looking at the economic and organizational reality and taking the specific circumstances and facts into consideration.

VAT grouping should allow taxable and non-taxable persons who “operate“ together and are “united” through the links whether financial, economic or organizational to be “one taxable person“. Those “linking factors“ can exist in different forms and different weights/strengths, depending on the circumstances and facts (size, type, organization and set-up of the economic activities) reflecting the economic reality. Therefore, not all links have to be fulfilled to the same extent and with the same weight. The overall picture of the economic activity and the economic reality is decisive.

Applying the conditions to be linked on a stand-alone basis and in a too strict and formal way, taking a form over substance (“ticking the box“) instead of a holistic approach would mean that certain taxable persons that are bound to one another and non-taxable persons (e.g. not for profit, charities, hospitals, public bodies) which are also economic units would fall outside the scope of the VAT grouping facility whereas on the ratio legis of VAT grouping they should not.

We view **the holistic approach as a best practice** and it is interesting to note that such approach is already applied in 10 out of the 16 Member States that already have VAT grouping. Germany also applied this best practice but this has changed in the last 15 years through local court cases causing legal uncertainty both for taxable persons and the VAT authorities.

- Member States with links not same weight / holistic approach (9)
- Member State with links not same weight / holistic approach if Members are fully taxable persons (1)
- Member States with links same weight / strict interpretation (4)
- Member States with financial link most important (2)
- Member State with financial link most important if Members are not fully taxable persons (1)



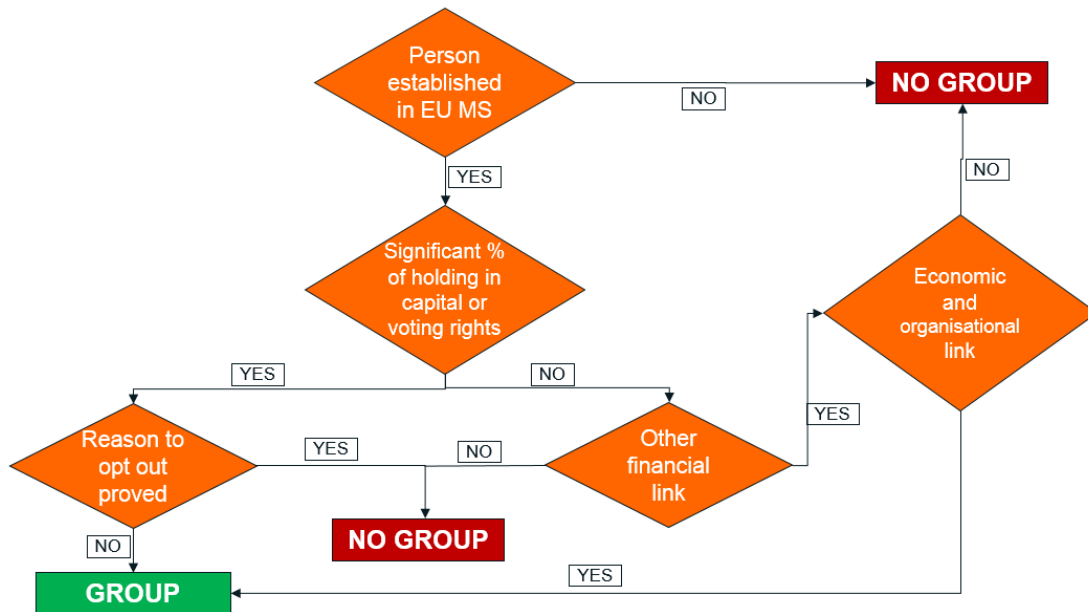
Source: Network Survey, PwC ITX Financial Services Network, October 2017

Article 11 does not preclude non-taxable persons (not engaged in an economic activity) from being included in a VAT group further to the case law of the Court of Justice. Only a holistic view enables them to fulfil the financial, economic and organizational links test. Furthermore, it also ascertains that “groups“ whether consisting of taxable persons only and of taxable and non-taxable persons are treated equally also respecting the neutrality principle (legal form neutrality). Additionally, applying the general input VAT deduction rules in a proper way ensures that the integrity of the VAT system is preserved.

Examples of the holistic approach

In this section, we explain using examples how the holistic approach is applied in practice and assures that the VAT group is indeed grouping taxable and non-taxable persons that are really and genuinely closely bound to one and another and consequently merit to be treated as “one“ taxable person, being a “VAT group“.

Examples/scenarios demonstrating/illustrating the holistic approach:



Firstly, the direct or indirect participation in capital can be **more than 50%**. Again note that while the parent company is abroad the local subsidiaries can still group (the local subsidiary with the biggest economic substance can act as VAT group parent). In that case, the financial link exists in a strong way (“protects” the financial interests of the shareholders) and the economic and organizational links, which are also existing (promoting the economic activity of the group parent and following the company standards, common policies and guidelines monitored by internal audit), are a given. Additionally, an indicator can be, if and as required, consolidation of financial accounts in accordance with accounting regulations.

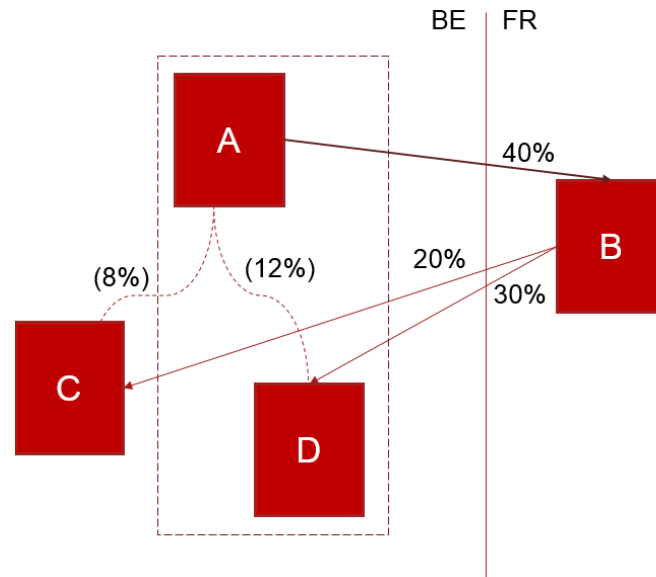
However, note that whether the local subsidiary carries out similar economic activities is not relevant.

Indeed, article 11 of the VAT Directive only refers to the independent legal persons being bound economically. The Directive is not requiring the activity to be similar or the same. The performance of an “economic activity” as described in article 9 of the VAT Directive suffices. Article 11 cannot limit or change the scope of article 9.

It is on this basis that Belgium, Spain and Italy resume that the independent (taxable) persons not only have close financial links but all have a “common” interest in their respective economic activities defined in accordance with article 9 of the VAT Directive and are as a matter of fact in view to keep “control” of the subsidiaries run as “one” organization.

Secondly, the direct or indirect participation in capital can be **less than 50%**. In that case the financial link is less strongly fulfilled which makes the consideration for economic and organizational links more important. Indeed, “common” organizational measures and processes need to be demonstrated.

As noted before the economic link is tied to the term “economic activity” from article 9 of the VAT Directive.



Note that while the parent company is abroad, the local subsidiaries can still group. In the above scheme, the financial link is established between A and D due to indirect shareholdings via foreign parent B.

Example:

A multinational enterprise intends to outsource its accounting department to a shared service center and the former manager of the accounting department becomes shareholder of that shared service center (owns 40% of the shares). The multinational enterprise is the only client (besides some very small external clients) of the service center and keeps 60% of the shares (inclusive of voting rights). The multinational enterprise and the shared service center are both part of a VAT group.

After one year, the multinational enterprise sells 20% of the shares to the manager, who then owns 60% of the shares. This entails that the multinational enterprise has a minority of the shares, but is, as the only client, still “in charge”. In principle, the links to form a VAT group are no longer met (looking at the links on a stand-alone (“tick the box”) basis), but based on the holistic approach the situation remains the same as before the sale of shares. The parties are still closely bound to one another by financial, economic and organizational links, if the economic and organizational links can be demonstrated, which can be done here through measures, such as economic metrics and quality assurance processes, decision making guidelines, standards and policies, etc.

Thirdly, a taxable person that possesses voting rights or shares profits may still group while having no capital participation.

In case the financial link is less strong or not existing, grouping should still be possible based on the economic and organizational links. As mentioned earlier, the organizational link can be demonstrated through the obligation to follow company and decision making guidelines, standards and policies, monitored and controlled by internal audit, management and operational structure and organizational set-up, but also consolidated accounts based on accounting regulatory requirements can be an indicator.

The same should be the case where based on the economic interest, independent persons can be linked by common management. The latter is common in the financial industry, e.g. fund industry with different third party investors as explained in the following example:

Example:

A company acts as originator of different funds. All the funds are owned by different investors but are originated/managed by the same entity/manager, who centralizes the management of the funds (e.g. portfolio management, promotion,...). The different investors do not have a participation in the management entity, but have a direct or indirect contractual control of the different activities of the manager. It is clear that all funds are not linked by strict financial links based on shareholding. However, they are certainly linked by means of organizational and economic links. This also applies for not-for profit associations, foundations, charities, not having capital but an interest to act as a group because of the link of their economic activities with a common management with strong organizational measures and processes in place.

Example:

The latter can also be demonstrated through a Dutch Court Case¹⁰ in which was said that a company A and a foundation B were closely linked.

A doctor holds 100% of the shares of a holding, which in its turn is 100% shareholder and the sole director of company A. Company A has 2 employees the doctor and his spouse.

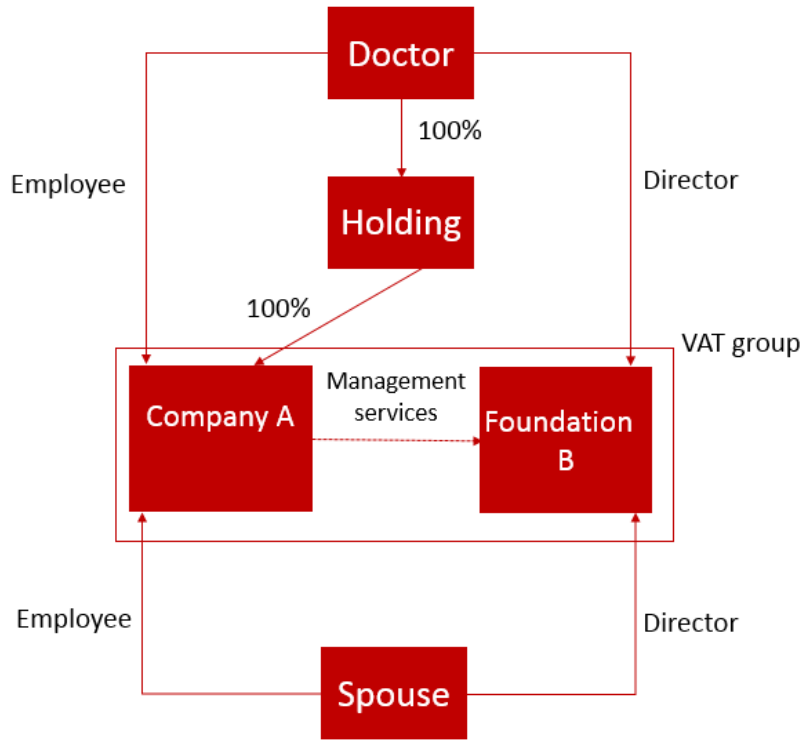
The doctor has created a foundation B (a not for profit) that provides medical care. The doctor and his spouse are both directors of foundation B. Foundation B has no employees and is located at the same address as company A. In its capacity of employee of company A, the doctor is responsible for the daily management of the foundation B. Company A charges a management fee to foundation B for the management services rendered.

The elements to sustain a close financial and organizational link between company A and foundation B were:

- The doctor is the only one that represents foundation B towards third parties;
- The doctor decides on the pricing of the services rendered by foundation B;
- The doctor concludes the agreements on behalf of foundation B;
- The doctor manages the bank accounts of both company A and foundation B;
- The doctor executes all activities of foundation B and is the “face” of foundation B.

It is clear that Company A (via the doctor) manages de facto the foundation including its financial affairs. Therefore, the Court accepts a VAT group between company A and foundation B.

¹⁰ [ECLI:NL:RBDHA:2014:8449 Rechtbank Den Haag, 09-07-2014, AWB-13_9316.](https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:62014:01001:ID.1)



Example:

In Belgium, entities without having share capital and which do not have a strong financial link between each other may still apply VAT grouping.

Indeed, the Belgian VAT authorities have decided that a close financial link also exists when one of the following conditions is fulfilled¹¹:

- A person owns at least 10% of the assets of a person other than a legal person with share capital represented by shares or units. This includes the situation in which a person A provides a person B assets without consideration and these assets represent a value of at least 10% of the assets of person B. However, note that the assets cannot be definitively acquired by B.
- A person undertakes to cover the operating losses of a person other than a legal person with share capital represented by shares or units. This includes the situation in which a person A irrevocably undertakes to assume the losses resulting from the economic activity of a person B. In contrast, the provision of a credit or a loan is not proof of a financial link.
- A person has significant or decisive influence over the management of a person other than a legal person with share capital represented by shares or units. This includes the situation in which a person A has, in respect of a person B, among others, the right to appoint or dismiss a majority of the directors or holds at least 20% of the voting rights at the general assembly meeting. However, the mere fact that members have one or more common directors is not proof of financial link.

¹¹ Administrative Decision - E.T.122.346 dd. 16.10.2014.

Please be aware that the link must have a permanent character, which means that this it must continue throughout the existence of the VAT group.

In addition, the VAT authorities will examine the specific situations that will be submitted to it and in each of these cases will determine whether such a link exists or not.

Example: franchise contracts

Franchise contracts and mutual participation as mentioned in the Commission paper are from our perspective not meeting the three links test. Indeed, Restaurants (such as McDonalds, Subway, etc.) and shop chains often operate a franchise model (the right to use the franchisors' business model and brand for a prescribed period of time). However, when it comes to the operation of the business itself every franchisee (such as individual restaurant or shop) operates economically, organizationally and financially independent from each other. Therefore, they cannot be seen as a single taxable person. This would be against the economic and legal intent of the relevant parties involved in the franchise set-up. In addition, this would also violating competition laws.

DRAFT