



EUROPEAN COMMISSION
DIRECTORATE-GENERAL
TAXATION AND CUSTOMS UNION
Indirect Taxation and Tax administration
Value added tax

taxud.c.1(2017)982178 – EN

Brussels, 16 February 2017

VALUE ADDED TAX COMMITTEE
(ARTICLE 398 OF DIRECTIVE 2006/112/EC)
WORKING PAPER NO 918

QUESTION
CONCERNING THE APPLICATION OF EU VAT PROVISIONS

ORIGIN:	Commission
REFERENCE:	Article 11
SUBJECT:	Meaning of "financial, economic and organisational links" among VAT group members

1. INTRODUCTION

The Commission services wish to discuss with the VAT Committee the meaning of the condition that to be regarded as a VAT group, the members making up the VAT group must be bound to one another by "financial, economic and organisational links" pursuant to Article 11 of the VAT Directive¹.

2. SUBJECT MATTER

Article 11 of the VAT Directive requires members of a VAT group to be closely bound by "financial, economic and organisational links". The VAT Directive does not define this threefold condition and the issue has never directly been dealt with by the Court of Justice of the European Union (CJEU), resulting in this test being understood and implemented in different ways by Member States making use of Article 11 of the VAT Directive. This creates uncertainty both for persons making use of VAT groups, or intending to do so, and for tax administrations.

With a view to promote a more uniform application of VAT grouping rules, including the "financial, economic and organisational links" requirement, the Commission issued a Communication in 2009². Despite the guidance given in that Communication, the "links test" is however still interpreted and applied unevenly.

Moreover, several judgments by the CJEU on VAT grouping have been issued since then and, although none of them directly concerns the "links test", they could be seen as having an impact on how financial, economic and organisational links are to be interpreted.

Hence, it is necessary to examine the meaning of the "links test". The need for a common interpretation and application of this test was also one of the key messages of the participants in the Fiscalis 2020 Seminar "Modernising VAT groups" held in Dublin in September 2016, which brought together mainly representatives of Member States in the Group on the Future of VAT (GFV) and members of the VAT Expert Group (VEG). Guidance on this issue was found to be a short-term feasible goal that could increase the legal certainty for businesses making use of VAT groups and for Member States, and the Commission's Communication was considered to be a valid starting point.

3. THE COMMISSION SERVICES' OPINION

3.1. Legal framework in the VAT Directive

The VAT grouping rules can be found in Article 11 of the VAT Directive and are optional for Member States to apply. Once applied, VAT grouping has the effect of treating a

¹ Council Directive 2006/112/EC of 28 November 2006 on the common system of value added tax (OJ L 347, 11.12.2006, p. 1).

² Communication from the Commission to the Council and the European Parliament on the VAT group option provided for in Article 11 of Council Directive 2006/112/EC on the common system of value added tax ([COM\(2009\) 325 final](#)). See in particular p. 8.

number of persons, who are closely linked to one another, as a single taxable person for VAT purposes³:

"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 organisational 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".

3.1.1. Context and objectives

In determining the scope of a provision of EU law, its wording, context and objectives must be taken into account⁴. In this respect, VAT groups were first introduced into EU law by the Second VAT Directive⁵, and later on regulated by the Sixth VAT Directive⁶ and reflected in the current VAT Directive. Although the relevant provision has been slightly amended over the years, the reference to financial, economic and organisational links has always been there.

It should nonetheless be noted that the linguistic versions of the relevant provision in the Second VAT Directive in listing the three requirements differed, notably as regards the use of the conjunction "or"/"and".

The English version of Annex A(2) to the Second VAT Directive stated, in relation to Article 4 of that Directive, that *"The expression 'independently' (...) makes it possible for each Member State not to consider as separate taxable persons, but as one single taxable person, persons who, although independent from the legal point of view, are, however, organically linked to one another by economic, financial or organisational relationships"*; while, for instance, the French and German versions of that provision made use of the conjunction "and" ("*...rappports économiques, financiers et d'organisation...*" and *... "durch finanzielle, wirtschaftliche und organisatorische Beziehungen...*" respectively).

Article 4(4) of the English version of the Sixth VAT Directive was later aligned with the rest of linguistic versions, resulting in the three requirements being listed cumulatively: *each Member State may treat as a single taxable person persons established in the territory of the country who, while legally independent, are closely bound to one another by financial, economic and organizational links"*.

³ For more information, see judgment of 22 May 2008, *Ampliscientifica and Amplifin*, C-162/07, EU:C:2008:301, paragraph 19.

⁴ Judgment of 8 December 2005, *Jyske Finans*, C-280/04, EU:C:2005:753, paragraph 34, and case-law cited.

⁵ Article 4 and Annex A(2) of the Second Council Directive 67/228/EEC of 11 April 1967 on the harmonisation of legislation of Member States concerning turnover taxes – Structure and procedures for application of the common system of value added tax (OJ, English Special Edition 1967(I), p. 16).

⁶ Article 4(4) of the Sixth Council Directive 77/388/EEC of 17 May 1977 on the harmonisation of the laws of the Member States relating to turnover taxes – Common system of value added tax: uniform basis of assessment (OJ L 145, 13.6.1977, p. 1).

Likewise, the present wording of Article 11 of the VAT Directive lays down a cumulative enumeration of the financial, economic and organisational links, thus requiring the three links to exist simultaneously.

With regard to the reasoning behind VAT groups, the Explanatory Memorandum to the proposal for a Sixth Directive further clarified that VAT groups were introduced "*either in the interests of simplifying administration or with a view to combating abuses such as, for example, the splitting-up of one undertaking among several taxable persons so that each might benefit from a special scheme, to ensure that Member States would not be obliged to treat as taxable persons those whose independence is purely a legal technicality*", as confirmed by the CJEU⁷.

In brief, VAT groups allow treating several legally independent persons as a single taxable person for VAT purposes, where such persons operate as a single person from a holistic perspective, that is, not only by taking into account its legal status. As a consequence, members of a VAT group are given the same VAT treatment as entities organised under the umbrella of one legal person, resulting in the transactions among VAT group members falling outside the scope of VAT, as it is the case for transactions between entities of the same legal person.

As already stated in the Commission's Communication, VAT groups could be described as a fiction created for VAT purposes, where economic substance is given precedence over legal form. In this case "economic substance" should be taken to comprise the three requirements laid down in Article 11 of the VAT Directive (the economic, financial and organisational links), which must be met for a group of legally independent persons to be treated as a single taxable person.

3.1.2. Transposition and interpretation of the "links test"

According to the CJEU, the condition that the formation of a VAT group is subject to the existence of close financial, economic and organisational links between the persons concerned needs to be specified at national level and has no direct effect. In the words of the CJEU, Article 11 of the VAT Directive "*is thus conditional inasmuch as it involves the application of national provisions determining the actual scope of such links*"⁸.

In turn, the financial, economic and organisational aspects of businesses and organisations are often at national level regulated by civil law. Hence, some could think that the "links test" in Article 11 of the VAT Directive may be defined merely by reference to such domestic provisions.

However, although Member States have some leeway when transposing provisions of the VAT Directive into national law, according to well-established CJEU case-law⁹ it follows from the need for uniform application of EU law and from the principle of equality that the terms of a provision of EU law which makes no express reference to the law of the

⁷ Judgment of 9 April 2013, *Commission v. Ireland*, C-85/11, EU:C:2013:217, paragraph 47.

⁸ Judgment of 16 July 2015, joined cases *Larentia + Minerva* and *Marenave Schiffahrt*, C-108/14 and C-109/14, EU:C:2015:496, paragraph 50.

⁹ Judgment of 29 October 2009, *NCC Construction Danmark*, C-174/08, EU:C:2009:669, paragraph 24, and case-law cited.

Member States for the purpose of determining its meaning and scope must normally be given an autonomous and uniform interpretation throughout the EU.

In the same line, the CJEU has in respect of VAT groups further specified that "*It is important, for a uniform application of the VAT Directive, that the notion of taxable person is interpreted autonomously and uniformly. In that context, such an interpretation is necessary for Article 11 of the VAT Directive, despite its optional nature for Member States, in order to avoid differences in application of that scheme between Member States when it is implemented*"¹⁰.

Therefore, it seems clear that the links should be defined by reference to the same elements across the EU. The purpose of this document is to trigger a debate about which these elements should be.

3.1.3. Objective versus subjective criteria

From the three links that must exist among VAT group members (financial, economic and organisational), it seems at first sight that the one capable of being assessed in most objective terms is the financial link.

Of course, requirements which can be examined according to objective criteria are always more clear and allow for more legal certainty, both for business and tax administrations. However, this should not lead to the conclusion that once the financial link is established, the economic and organisational links can be presumed present. If this was the case, the threefold test (i.e. financial, economic and organisational links) would be reduced to one condition (i.e. the financial link only).

Moreover, had this been the case, the legislator would not have felt the need also to mention economic and organisational ties. *A sensu contrario*, the fact that all three ties have been explicitly referred to suggests that an assessment of each of these is necessary.

Whilst presumptions could be established in respect of a particular situation meeting one of the three links (e.g. where there is a company with more than 50% of participation in another, the financial link could be presumed to exist, as analysed in section 3.4.2), it is still so that the conditions are cumulative and each of them has to be assessed independently. Therefore, setting up presumptions whereby all other links are taken to be there as soon as one link exists (e.g. economic and organisational links are presumed to exist, once there is a financial link) is not possible.

3.2. The Commission's Communication of 2009

In an attempt to clarify some of the aspects linked to VAT groups, the Commission in its Communication found that, with regard to "financial, economic and organisational links":

"... this condition is to be interpreted as meaning that all three links have to be met during the entire time a VAT group exists and, that any member no longer fulfilling all three links, should be required to leave the VAT group. The reasons for this are the following:

¹⁰ Judgment of 25 April 2013, *Commission v Finland*, C-74/11, EU:C:2013:266, paragraph 62 (our translation).

- *First, it follows from the use of the coordinating conjunction 'and' that the conditions are cumulative.*
- *Second, since the VAT group is a special concept of taxable person and thus functions on an exceptional basis, it is essential that it is linked to fairly strict conditions, which is ensured by the accumulation of the above-mentioned requirements.*
- *Third, such an accumulation contains further guarantees against abusive application of VAT groups, since it helps to exclude purely artificial structures devoid of any economic significance.*

In view of the general principles guiding this provision, the Commission considers that the following definitions of the three links could serve as guidelines.

The financial link: *Defined by reference to a percentage of participation in the capital or in voting rights (over 50%), or defined by reference to a franchise contract. This guarantees that one company has the actual control of another.*

The economic link: *Defined by reference to the existence of at least one of the following situations of economic cooperation. The principal activity of the group members is of the same nature, or the activities of the group members are complementary or interdependent, or one member of the group carries out activities which are wholly or substantially to the benefit of the other members.*

The organisational link: *Defined by reference to the existence of a shared, or at least partially shared, management structure".*

3.3. Case-law of the CJEU and possible impact on the "links test"

Since the Commission issued its Communication several judgments of the CJEU have dealt with VAT groups, some of which could be seen as having an impact on the interpretation of the "financial, economic and organisational links".

3.3.1. Relevant case-law

Commission v Ireland: concept of "persons"

Article 11 of the VAT Directive simply refers to "persons" being able to join a VAT group, which the CJEU acknowledged in a series of judgments¹¹ to cover taxable persons but also non-taxable persons, thus overriding the position laid down in the Commission's Communication.

According to the reasoning of the CJEU, it cannot be inferred from the words "as a single taxable person" that Article 11 of the VAT Directive seeks solely to permit a number of

¹¹ Judgment of 9 April 2013, *Commission v Ireland*, C-85/11, EU:C:2013:217; judgment of 25 April 2013, *Commission v Czech Republic*, [C-109/11](#), EU:C:2013:269; judgment of 25 April 2013, *Commission v Denmark*, C-95/11, EU:C:2013:268; judgment of 25 April 2013, *Commission v UK*, [C-86/11](#), EU:C:2013:267; and judgment of 25 April 2013, *Commission v the Netherlands*, [C-65/11](#), EU:C:2013:265.

taxable persons to be dealt with as a single entity, as those words relate, not to a condition for the application of that article, but to its outcome, which is that a number of persons are regarded as a single taxable person.

As regards the relationship between Articles 9 and 11 of the VAT Directive (dealing with the concepts of taxable persons and VAT groups respectively), the CJEU concluded that a combined reading does not support the conclusion "*that the persons referred to in Article 11 must individually satisfy the general definition of a taxable person set out in Article 9(1) of that directive. A comparison of those two provisions does not preclude the interpretation that (...) it is those persons, taken together and closely bound to one another by financial, economic and organisational links, who must collectively satisfy that definition*"¹². According to the CJEU, allowing non-taxable persons to be VAT group members is also compatible with the objectives of VAT groups, notably that of administrative simplification.

Larentia + Minerva: notion of "control"

The judgment in *Larentia + Minerva*¹³ concerned a group of partnerships without legal personality which were denied the possibility to form a VAT group (*Organschaft*) in Germany on the grounds that they did not meet the requirements established in the national legislation.

According to the German legislation, two conditions must be met for forming a VAT group: (i) being a legal person; and (ii) being "*integrated into the undertaking of the controlling company*" of the VAT group, which is understood by domestic case-law as requiring a "*relationship of control and subordination*". In this respect, it should be noted that the requirement of control and subordination laid down in German law referred not only to the financial link, but also to the economic and organisational links ("*a legal person is integrated in financial, economic or organisational terms into the undertaking of the controlling company*").

One of the questions posed to the CJEU was whether the two requirements laid down in the German legislation were in line with EU legislation. The CJEU concluded that national legislation which reserves the right to form a VAT group solely to entities with legal personality and linked to the controlling company of that group in a relationship of subordination is incompatible with the VAT Directive, except where such limitation is necessary and appropriate to prevent abusive practices.

In particular, the CJEU in respect of the second condition reasoned that: "*The fact that the nature of the relationship binding those persons is merely one of 'closeness' may, in the absence of any other requirement, not therefore lead to the conclusion that the EU legislature intended to reserve the benefit of the VAT group scheme only to entities in a relationship of subordination with the controlling company of the group of undertakings considered. Although the existence of such a relationship of subordination allows it to be presumed that relations between the persons at issue are close, it cannot however, in*

¹² *Commission v Ireland*, paragraph 45.

¹³ Judgment of 16 July 2015, joined cases *Larentia + Minerva* and *Marenave Schiffahrt*, C-108/14 and C-109/14, EU:C:2015:496.

principle, be regarded as a condition which is necessary for the constitution of a VAT group...¹⁴.

Therefore, according to this judgment, a parent-subsidiary¹⁵ relationship between two companies is a condition sufficient but not necessary for potential VAT group members being considered to be "close" according to the German legislation. In other words, while a parent-subsidiary relationship will allow presuming the existence of close links for the purposes of the German requirement, the existence of such links cannot be dependent upon there being that parent-subsidiary relationship between two companies.

3.3.2. Possible impact on the "links test"

Eligibility

The Commission's Communication was based on the idea that only taxable persons could be eligible for forming a VAT group and, therefore, the guidance on the "links test" (notably, the financial link) was focused on VAT groups formed by companies only.

According to the CJEU, however, "persons" being able to form a VAT group pursuant to Article 11 of the VAT Directive may cover both taxable and non-taxable persons¹⁶, as well as legal persons and entities without legal personality¹⁷. This could, in principle, leave the door open to entities other than companies, such as partnerships or foundations, being also eligible for VAT groups.

Therefore, the assessment of whether there exists a close financial link in circumstances other than those envisaged in the Commission's Communication (i.e. in cases where VAT group members are not companies) would, in particular, have to be analysed.

Interpretation of the financial link

Some might see the judgment of the CJEU in *Larentia+Minerva* as contradicting the guidance set out in the Commission's Communication that a financial link could be defined by reference to a percentage of participation of more than the 50% in the capital or in voting rights, because that *de facto* requires one company to be the parent of another company, its subsidiary, and also is based on the notion of control.

The Commission services nonetheless tend to believe that the interpretation of the notion of financial link derived from *Larentia + Minerva* is compatible with the content and the objectives of the guidance already given.

¹⁴ *Larentia + Minerva*, paragraphs 44-45.

¹⁵ Despite the specific differences that may exist at national level, it is common understanding that where a company acquires a significant participation in the ownership of another business, it becomes the "parent company" – or "holding company" – of the latter. The company whose shares have been acquired by the parent company is referred to as "subsidiary". Such concepts must be distinguished from "head office" and "branch", which refer to the main place and a fixed establishment of a business respectively. Whilst a parent company and a subsidiary remain different legal entities, a head office and its branch make up one and the same legal person. As a result of this, a parent company and its subsidiaries (different legal entities) would be able to form a VAT group, while a head office and its branches (the same legal entity) could not.

¹⁶ *Commission v Ireland*

¹⁷ *Larentia + Minerva*.

The guidance did not intend to comprehensively cover all the circumstances where the financial link requirement is met. Neither did the guidance intend to limit the existence of a close financial link to parent-subsidary cases, as evidenced by the fact that the Commission also suggested that the financial link could be defined by reference to a franchise contract (where there may not be a participation of over 50% of one party in the capital or voting rights of another). The definitions of the financial link suggested in the guidance should therefore rather be seen as presumptions of cases where the financial link would exist (i.e. cases which are "sufficient" but not "necessary" for passing the financial test). The use of this test as a possible presumption is expressly mentioned in *Larentia + Minerva*: "Although the existence of such a relationship of subordination allows it to be presumed that relations between the persons at issue are close..."¹⁸.

Moreover, the relationship of control by one company in the VAT group and subordination of the others in that group may still be required. That would be so where Member States find it appropriate and necessary in order to prevent abusive practices or behaviour or to combat tax evasion or tax avoidance, as confirmed by the CJEU.

What the judgment of the CJEU in *Larentia + Minerva* rather seems to indicate is that it is necessary to establish the meaning of "financial link" by allowing for criteria other than there being a relationship of subordination with a controlling company (i.e. a parent-subsidary relationship). Whilst the latter test could be used as a presumption, it cannot constitute the minimum condition which must be met in order to be closely bound by a financial link.

3.4. Possible way forward

The above case-law of the CJEU may have an impact on the "links test", notably on the interpretation of the financial link.

In this respect, what has to be determined in the first place is the minimum content of the financial link requirement, that is, the conditions which at least have to be met by two or more persons to be seen as closely bound to one another by a financial link.

Following *Larentia+Minerva*, the minimum content of the financial link cannot be defined by reference to a relationship of control between VAT group members (e.g. parent-subsidary relationship, such as having over 50% of participation in the capital or in voting rights). Moreover, the fact that those eligible to form a VAT group may be both taxable and non-taxable persons, with or without legal personality, also precludes defining the minimum content of the financial link by reference to capital or voting rights, which are typical characteristics of companies.

It may be that it is not feasible to arrive at a singular definition of the minimum content of the financial link. For that reason, it should also be examined whether presumptions can be established in respect of the financial link. Guidance laid down in the Commission's Communication should be seen as an outline of a number of possible presumptions, which would increase the legal certainty for businesses and tax administrations.

The economic and organisational links would not seem to be directly affected by the abovementioned case-law of the CJEU. However, given that the guidance proposed in the

¹⁸ *Larentia + Minerva*, paragraph 45.

Commission's Communication is quite vague, a renewed attempt to define such links in a more precise way should be made.

It is worth noting that, although VAT groups can be formed by two or more persons, the analysis of the links below and the examples given mainly assume that only two persons are involved, for the sake of simplicity. The application of each of the link tests in scenarios with more than two VAT group members could also be examined, if necessary, at a later stage.

3.5. The financial link

3.5.1. Minimum content of the financial link test

The CJEU in *Larentia+Minerva* determined what the minimum content of the financial link test cannot consist of (i.e. it cannot be based on a relationship of control and subordination), but did not shed light on what that content should then be. In this respect, the minimum content of this test could be based on one or the other of the two options outlined below (or a combination of both), without prejudice to other options which could also be explored.

As regards the minimum condition that two (or more) persons should satisfy in order to be seen as closely bound by a financial link, two aspects must be taken into account.

Firstly, given that non-taxable persons and persons with no legal personality may be eligible for a VAT group, the financial link ought to be defined by reference to concepts which are not exclusive to certain types of legal persons (e.g. companies).

And secondly, Article 11 of the VAT Directive does not merely refer to the existence of a financial link, but requires VAT group members to be "closely bound" by a financial link. Such reference cannot be ignored. If the provision had not referred to the need for this close tie, two undertakings somehow financially related (e.g. one holding a few shares of the other) could already be considered to have a financial link. However, for two entities to be seen as closely bound by a financial link, a stricter test would need to be applied. Although the CJEU found that this test should in principle not be understood as requiring a relationship of "control and subordination", the minimum content of the financial link test should still reflect that higher degree of exigency derived from the word "close".

- Option 1: interlinked financial instruments

"Financial" is defined as "*relating to finance*"¹⁹. Therefore, a "financial link" for the purposes of Article 11 of the VAT Directive may be interpreted as referring to the finances of VAT group members. In turn, finances are defined as "*the monetary resources and affairs of a state, organization, or person*"²⁰. Where applied to corporations, (i.e. corporate finances), this concept is usually understood as covering the financial instruments of a company, that is, their assets, liabilities, and equity.

¹⁹ Oxford Dictionary of English (online version), Oxford University Press, 2015.

²⁰ *Ibid.*

According to the International Accounting Standard²¹ (IAS) No 32²² as regards financial instruments, financial assets mainly cover cash and contractual rights (e.g. bank deposits and the holding of bonds); financial liabilities mainly cover contractual obligations (e.g. the repayment of loans or the issuing of bonds); and equity refers to the difference between assets and liabilities (e.g. the stock derived from the issuing of shares, where the issuer does not have a contractual obligation to make any payment, is equity).

Requiring two undertakings to be closely bound by a financial link could then be taken to mean that one undertaking must have substantial financial assets and/or liabilities in respect of the other undertaking, or have a substantial participation in the equity (also known as capital) of the other. Where VAT group members are not companies, the test could be understood as requiring such persons to have substantial financial rights and/or liabilities in respect of the other VAT group members.

- **Option 2:** financially dependent persons (not bearing their own financial risk)

Maybe a parallel could also be drawn between having a close financial link for the purposes of Article 11 of the VAT Directive and the existing case-law of the CJEU in respect of Article 9 of that Directive, which defines taxable person as any person who, independently, carries out in any place any economic activity, whatever the purpose or results of that activity. According to this case-law, a person acting "independently" is one who takes the economic risk arising from its business.

For instance, the CJEU found in *FCE Bank* that "*a provision of services is taxable only if there exists between the service provider and the recipient a legal relationship in which there is a reciprocal performance (...) To establish whether such a legal relationship exists between a non-resident company and one of its branches (...) it is necessary to determine whether FCE IT carries out an independent economic activity. It is necessary in that regard to determine whether a branch such as FCE IT may be regarded as being an independent bank, in particular in that it bears the economic risk arising from its business*"²³. Therefore, a head office and its branch would qualify as the same taxable person where the branch does not bear the risk of its economic activity.

Based on that, the financial link test in Article 11 of the VAT Directive could be said to require that the VAT group members are financially dependent. This would mean, for instance, that in a VAT group made up of two persons, one of them is not acting independently from the other financially speaking and, therefore, that his financial risk is not borne mainly by himself but by the other VAT group member.

The very wording of Article 11 of the VAT Directive seems to imply that the only "independence" existing among group VAT group members is the legal one. Therefore, *a sensu contrario*, the fact that they have to be closely bound to one another could be understood as meaning that there is a certain degree of dependency among them as regards

²¹ International Accounting Standards (IAS) and International Financial Reporting Standards (IFRS) are a single set of accounting standards, developed and maintained by the International Accounting Standards Board with the intention of those standards being capable of being applied on a globally consistent basis. They are adopted and used in the EU pursuant to Regulation (EC) No 1606/2002 of the European Parliament and of the Council of 19 July 2002 on the application of international accounting standards (OJ L 243, 11.9.2002, p. 1).

²² <http://eifrs.ifrs.org/eifrs/bnstandards/en/2016/ias32.pdf>

²³ Judgment of 23 March 2016, *FCE Bank*, C-210/04, EU:C:2006:196, paragraphs 34-35.

the financial, economic and organisational aspects of their businesses. This would seem to be in line with the *ratio legis* of VAT groups. In particular, Annex A(2) to the Second Directive explains in respect of Article 4 of that Directive that "*the expression 'independently' is intended in particular to exclude from taxation wage-earners who are bound to their employer by a contract of service. This expression also makes it possible for each Member State not to consider as separate taxable persons, but as one single taxable person, persons who, although independent from the legal point of view, are, however, organically linked to one another by economic, financial or organizational relationships*".

Some concerns may arise as regards this interpretation of the financial link. Notably, it could be argued that if it is required for two persons closely bound by a financial link to be financially dependent on one another, they could not qualify as taxable persons pursuant to Article 9 of the VAT Directive because they would not be able to carry out an economic activity "independently". As a result of this, some taxable persons may be seen as excluded from the possibility to form a VAT group.

However, the notion of independence in Article 9 of the VAT Directive could be said to refer to the way how the economic activities are carried out, rather than to the financial positions of the persons carrying out such activities. In other words, it could be possible for two financially dependent persons to carry out economic activities independently or *vice versa*. Such distinction would seem to be in line with the existing case-law of the CJEU.

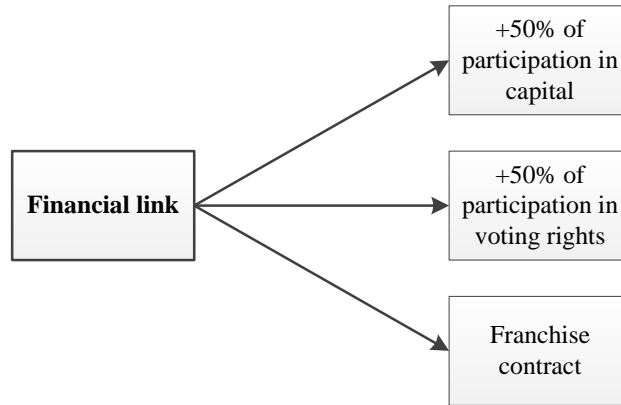
For instance, in *X* the CJEU found that: "*unlike the holding of the assets of an undertaking, the holding of shares in an undertaking is not sufficient to allow an independent economic activity to be carried on*"²⁴. Therefore, the fact that two persons are financially dependent as a result of the holding of shares would not necessarily preclude them from carrying out independent economic activities.

3.5.2. Presumptions

Irrespective of the fact that a common denominator may be determined as regards the minimum content of the financial link, for the sake of legal certainty there is a need for presumptions (i.e. cases where the financial link could be deemed to exist). What is described in the Commission's Communication, albeit not being necessary for considering that two or more entities are closely bound by a financial link, may serve as a basis for setting up those presumptions, which are looked at in more detail below. Other presumptions could also be envisaged.

According to the guidance provided in the Commission's Communication the financial link could be defined by reference to a percentage of participation in the capital, or a percentage of participation in voting rights (over 50%), or by reference to a franchise contract; which would guarantee that one company has the actual control of another.

²⁴ Judgment of 30 May 2013, *X*, C-651/11, ECLI:EU:C:2013:346, paragraph 35.



3.5.2.1. Presumption 1: participation in another company (over 50%)

Some of the guidance regarding the definition of the financial link referred to the fact that a company has a percentage of participation in the capital or in voting rights (over 50%) of another company. That could serve as the basis of one presumption.

In this respect, two aspects shall be analysed: (i) whether such participation has to be direct or indirect; and (ii) whether the participation can be in either capital or voting rights, or only in voting rights.

i. Nature of participation: direct or indirect?

It should be clarified if such participation, either in capital or in voting rights, has to be direct or indirect in order for a financial link between companies to exist.

Direct participation refers to cases where a company has shares or voting rights in another company without intermediaries (e.g. company A owns 50% of shares in company B); while indirect participation covers cases where that relationship is established through a third company (e.g. company A owns 50% of shares in company B which, in turn, owns 50% of shares in company C).

Although there is no case-law on this specific issue, the joined cases *Van Passen* and *Denkavit Dienstbetoon*²⁵ could be seen as remotely dealing with a similar question²⁶. In *Van Passen* a company owned, via a wholly-owned subsidiary, all the shares of another company with which a VAT group was allegedly formed. In *Denkavit Dienstbetoon*, the two companies which arguably formed a VAT group were controlled by the same shareholder, who was not part of the VAT group. Although the CJEU did not expressly analyse the financial link, it could be derived from the judgment that such company structures were found compatible with being able to form a VAT group.

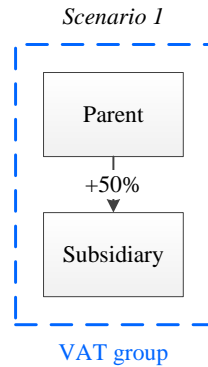
Given the lack of guidance to be found in the existing case-law and legislation, it may be useful to consider several scenarios involving different business structures, with both direct and indirect participation.

²⁵ Judgment of 12 June 1979, joined cases *Van Paassen* and *Denkavit Dienstbetoon*, C-181/78 and C-229/78, EU:C:1979:151.

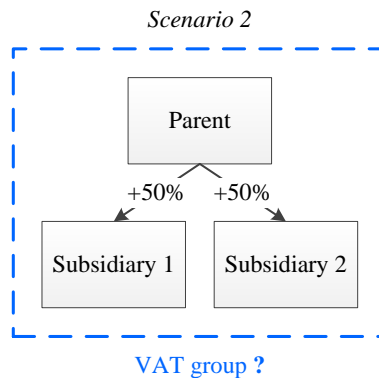
²⁶ Also suggested by S. Pfeiffer, "VAT Grouping from a European Perspective", IBFD 2015, Online Books IBFD, section 5.2.3.1.

Direct participation

It seems clear that a financial link would be established in cases where one VAT group member has a direct participation in another VAT group member, as illustrated in scenario 1.

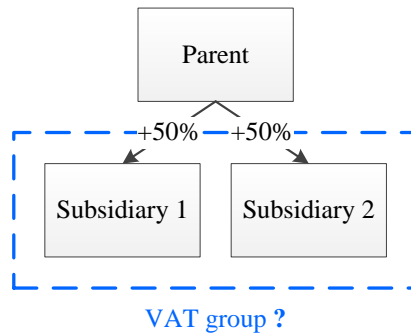


Scenario 2 concerns a parent company with a participation of more than 50% in two different subsidiaries. Although there is no direct participation of one subsidiary in the other subsidiary, both of them are effectively controlled by the same person. It could therefore be argued that the two subsidiaries have a close financial link through the parent company and that the three should be eligible to form a VAT group.



In scenario 3, where the parent company could not be part of a VAT group formed by the two subsidiaries (e.g. because it is established in another country), the question is whether the subsidiaries could form a VAT group on their own. On the one hand, it could be argued that the two subsidiaries are still controlled by the same person regardless of whether the parent company is a VAT group member. That would lead to the conclusion that the two subsidiaries could form a VAT group without their parent company. On the other hand, it may be claimed that the parent company, not being a VAT group member, would weaken the financial link between the members of the VAT group so that it would not be sufficiently close.

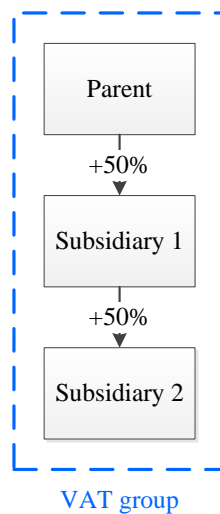
Scenario 3



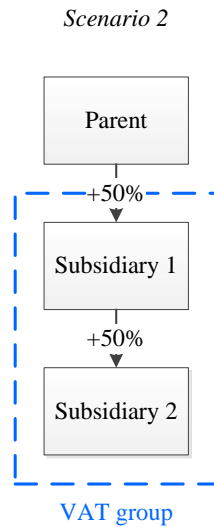
Indirect participation

In scenario 1, VAT group members are directly and indirectly controlling other members. Notably, the parent company is directly in control of subsidiary 1, and indirectly in control of subsidiary 2. Subsidiary 1 is, in turn, directly participating in the capital or in the voting rights of subsidiary 2. It seems therefore that a financial link would exist between the members of a VAT group formed by the three companies.

Scenario 1



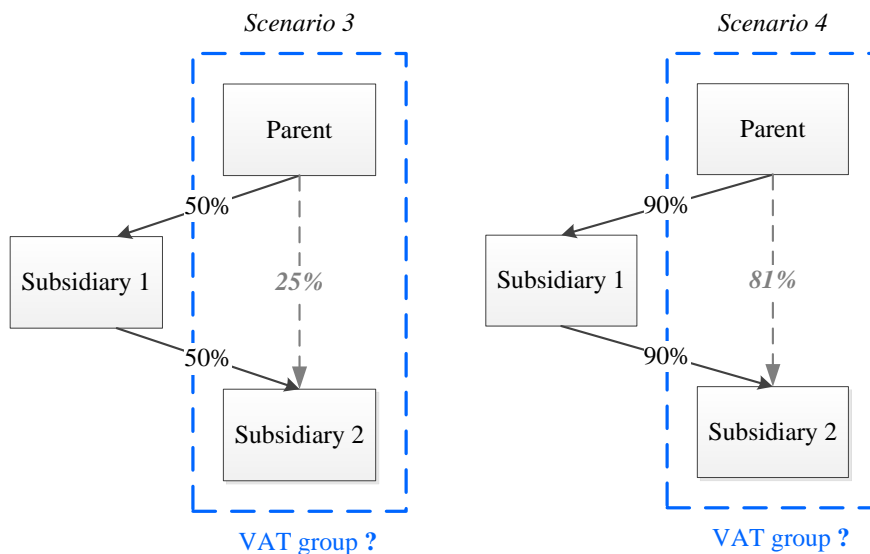
Scenario 2 excludes from the VAT group the parent company, but it seems that the remaining VAT group members would still be closely bound by a financial link, since one of them remains in direct control of the other.



In scenarios 3 and 4, a parent company participates indirectly in subsidiary 2. Let us assume that the interposed company between the two (subsidiary 1) cannot form part of a VAT group with them, for instance, because it is established in another country.

In such circumstances, it could be argued that there exists a financial link between the parent and the subsidiary 2, even if that link is indirect, provided that the parent company can effectively exercise control over subsidiary 2 (i.e. where indirect participation of the parent in subsidiary 2 is over 50%). This would ensure a relationship of control between the entities actually making up the VAT group.

According to this reasoning, in scenario 3 the indirect participation of the parent in subsidiary 2 would only be 25% (50% x 50%), thus not sufficient in terms of the set minimum of 50%. In contrast, in scenario 4 the parent company holds an indirect participation in subsidiary 2 of 81% (90% x 90%), thus being able to control it. This would imply that such two companies are closely bound by a financial link.



ii. *Instruments of participation: in the capital/voting rights or in voting rights only?*

Given that voting rights generally stem from the participation in the capital, some could question the distinction that is made between "participation in the capital" and "participation in voting rights". Therefore, two alternative options as regards the definition of the presumption are presented below: (i) participation in capital or in voting rights; and (ii) participation in voting rights only.

- **Option 1:** participation in the capital or in voting rights

One approach could be to establish the presumption as regards the financial link by reference to a participation of over 50% either in the capital or in the voting rights.

"Capital" of a company could be described in plain words as the amount of money invested in that company in exchange for its ownership²⁷. Hence, "participation in the capital" of a company relates to the ownership of that company.

Companies are legal persons, as opposed to natural persons, with a legal status that is separate from the individuals involved in them, who may have different and incompatible interests. Hence, the governance problem to be solved in setting up any company is to create a democratic mechanism for selecting and overseeing the firm's decisions²⁸. In the majority of systems, it is the company's general meeting which has the power to deliberate major changes in the financial and legal structure of a corporation²⁹.

The concepts of "voting rights" and "participation in voting rights" allude to the rights that owners (e.g. shareholders) of a company have to vote on corporate strategic decisions in general meetings (e.g. shareholders' meetings).

Such voting rights are often referred to when "control" of a company is defined, that is as *"the ability to win votes at company general meetings. Any person or group holding over 50 percent of the voting ordinary shares can exercise control; in practice control is usually possible with considerably under 50 percent of the voting shares, provided that the other shareholders do not combine"*³⁰.

While participation in the capital of a company usually encompasses participation in voting rights of that company (i.e. the shareholder of a company would usually be granted a voting right in the shareholders' meeting of that company), this may not always be the case. As expressed by some authors, *"almost all the legal systems statutorily prohibit cumulative voting and provide that every share should have no more than one vote. Nonetheless, it is permitted, and indeed common, that corporations issue more than one*

²⁷ Where such capital has been obtained through the issue of shares, owners are referred to as shareholders.

²⁸ M. M. Blair, "International Encyclopedia of the Social & Behavioral Sciences: Corporate governance", Elsevier Science Ltd, 2001, p. 2797.

²⁹ P. Marchetti and V. Ventoruzzo, "International Encyclopedia of the Social & Behavioral Sciences: Corporate law", Elsevier Science Ltd, 2001, p.2807.

³⁰ J. Black, N. Hashimza and G. Myles, "A Dictionary of Economics: control (of a company)", Oxford University Press, 2013.

class of stock, granting different rights for each class (for example, one class of voting shares and one class of non-voting shares with stronger economic rights)"³¹.

Accordingly, there could be cases where a majority shareholder of a company (having a participation of more than 50% in the capital), may not actually be able to exercise control of that company (e.g. because the shareholder does not hold a majority in voting rights).

It is also worth noting that holding the majority in the voting rights of a company is not always necessary for actually controlling that company. In some cases, an entity with less than 50% of voting rights may control a company by virtue of agreements with other shareholders³², or where the other shares are widely spread among many minor shareholders. For instance, and assuming the "one share, one vote" distribution of voting rights, 1 shareholder with 40% of the capital of a company could actually control that company, if the other capital is spread among 6 non-coordinated shareholders with 10% of the capital each.

What seems clear, though, is that a participation of over 50% in the capital of a company or a participation of over 50% in the voting rights of a company would generally allow presuming the existence of a close financial link based on the notion of control, as summarised below.

- . *Participation in the capital (over 50%)*: according to company law and the standard rule of "one share, one vote", the owner of more than half of an undertaking's capital would usually hold more than half of that undertaking's voting rights, and would thus be able to control it.
- . *Participation in the voting rights (over 50%)*: the holder of more than half of an undertaking's voting rights would usually be able to control such an undertaking. As regards the percentage of voting rights, it is true that minority shareholders (with less than 50% of the capital and less than 50% of voting rights) could still have control of an undertaking. However, while holding less than 50% of voting rights may in some cases lead to control, holding over 50% of the voting rights guarantees control of an undertaking. Hence, it seems safer requiring holding at least 50% of voting rights in order to be able to presume the existence of a financial link.
- **Option 2**: participation in voting rights only

An alternative approach could be to establish the presumption as regards the financial link only by reference to a participation of over 50% in the voting rights. Dropping the reference to participation in the capital would seem to have a limited effect, since being a majority shareholder of a company only grants control of it as long as a majority of voting rights is derived from that shareholding. It could therefore be argued that participation in the capital is already covered, indirectly, by way of the reference to voting rights.

³¹ P. Marchetti and V. Ventoruzzo, *op.cit.*

³² See P. Stacey, "A rational basis for setting GST and VAT grouping thresholds", *International VAT Monitor*, June 2006, p. 187.

Directive 2013/34/EU³³ which regulates the consolidated financial statements for accounting purposes, also takes as reference point the majority in the voting rights. In fact, that Directive requires presenting consolidated financial statements of "groups" of companies forming a single economic entity, which is an idea that very much resembles that behind VAT groups.

According to recital 35 of Directive 2013/34/EU, "*Consolidated financial statements should present the activities of a parent undertaking and its subsidiaries as a single economic entity (a group). Undertakings controlled by the parent undertaking should be considered as subsidiary undertakings. Control should be based on holding a majority of voting rights, but control may also exist where there are agreements with fellow shareholders or members. In certain circumstances control may be effectively exercised where the parent holds a minority or none of the shares in the subsidiary*".

Article 22(1) of that Directive sets out the conditions according to which undertakings shall be required to prepare consolidated financial statements, and they refer either to voting rights only, or to participation in the capital and in voting rights (or similar types of control):

"1. A Member State shall require any undertaking governed by its national law to draw up consolidated financial statements and a consolidated management report if that undertaking (a parent undertaking):

- (a) *has a majority of the shareholders' or members' voting rights in another undertaking (a subsidiary undertaking);*
- (b) *has the right to appoint or remove a majority of the members of the administrative, management or supervisory body of another undertaking (a subsidiary undertaking) and is at the same time a shareholder in or member of that undertaking;*
- (c) *has the right to exercise a dominant influence over an undertaking (a subsidiary undertaking) of which it is a shareholder or member, pursuant to a contract entered into with that undertaking or to a provision in its memorandum or articles of association, where the law governing that subsidiary undertaking permits its being subject to such contracts or provisions.*

A Member State need not prescribe that a parent undertaking must be a shareholder in or member of its subsidiary undertaking. Those Member States the laws of which do not provide for such contracts or clauses shall not be required to apply this provision; or

- (d) *is a shareholder in or member of an undertaking, and:*
 - (i) *a majority of the members of the administrative, management or supervisory bodies of that undertaking (a subsidiary undertaking) who have held office during the financial year, during the preceding financial year and up to the*

³³ Directive 2013/34/EU of the European Parliament and of the Council of 26 June 2013 on the annual financial statements, consolidated financial statements and related reports of certain types of undertakings, amending Directive 2006/43/EC of the European Parliament and of the Council and repealing Council Directives 78/660/EEC and 83/349/EEC (OJ L 182, 29.6.2013, p. 19).

time when the consolidated financial statements are drawn up, have been appointed solely as a result of the exercise of its voting rights; or

- (ii) *controls alone, pursuant to an agreement with other shareholders in or members of that undertaking (a subsidiary undertaking), a majority of shareholders' or members' voting rights in that undertaking. The Member States may introduce more detailed provisions concerning the form and contents of such agreements.*

[...]"

Guidance laid down in the International Financial Reporting Standards (IFRS) No 10³⁴ as regards consolidated financial statements also defines parent companies by reference to their voting rights in one or more investees.

Pursuant to IFRS No 10, the investor must have "power" over the investee, i.e. the investor must have existing rights that give it the ability to direct the activities that significantly affect the investee's returns. In turn, according to this guidance, "*Power arises from rights. Sometimes assessing power is straightforward, such as when power over an investee is obtained directly and solely from the voting rights granted by equity instruments such as shares, and can be assessed by considering the voting rights from those shareholdings. In other cases, the assessment will be more complex (...) for example when power results from one or more contractual arrangements*".

This all leads to consider whether it is appropriate to establish a presumption as regards the existence of a financial link by reference to the participation in voting rights only (and not to participation in capital).

3.5.2.2. *Presumption 2: groups presenting consolidated financial statements*

With Directive 2013/34/EU on consolidated financial statements in mind, another presumption could be that groups of undertakings meeting the criteria laid down in that Directive for having to present consolidated financial statements for accounting purposes would automatically qualify as being closely bound by a financial link for the purposes of Article 11 of the VAT Directive.

As explained above, accounting rules on consolidation are based on the concepts of control among a parent company and its subsidiaries, circumstances which would seem to lead to the financial link having been established.

3.5.2.3. *Presumption 3: franchise contract*

Where there is a franchise contract, there may be room for another presumption. Two parties which have entered into a franchise contract could, according to the Commission's Communication, be presumed to be closely bound to one another by a financial link.

A franchise agreement is typically defined as a contractual arrangement between two legally independent firms, whereby one party (the franchisee) pays another party (the franchisor) for the right to sell the franchisor's product or the right to use his trademarks in

³⁴ <http://eifrs.ifrs.org/eifrs/bnstandards/en/2016/ifrs10.pdf>. For more information see footnote 21.

a given location for a specified period of time³⁵. Also, "in a traditional franchise, franchisors sell a finished or semi-finished product to franchisees at a mark-up, as in gasoline stations, car dealerships, and soft drink bottling franchises. In business format franchising, by contrast, the franchisee receives a trade name and a complete business plan in exchange for the payment of a franchise fee and royalties, as in fast-food and automotive repair franchises"³⁶. For the franchisor, this system is an alternative to investing in the creation of its own stores, while the franchisee is able to profit from the economy of scale and the know-how of the franchisor.

Although the companies may not have a participation in the capital or in the voting rights of one another, one company could be seen as having the actual control of the other, which was the foundation upon which the interpretation of the financial link was built in the Commission's Communication.

Account must also be taken of the fact that, according to the characteristics of the franchise agreement, the business activity of the companies involved is interlinked (i.e. the activity of the franchisee is mainly dependent on the input received from the franchisor, and the franchisor's activity largely depends on franchisees making goods and services available to final consumers). Besides, the management role of the franchisee can be said to be limited to some extent by the constraints imposed by the franchisor.

As a result of this, a franchisor and a franchisee could perhaps rather be seen as closely bound from the perspective of the economic and/or the organisational links (sections 3.6 and 3.7 respectively). If that is the view taken, a franchise contract should not necessarily be seen as a presumption for a financial link.

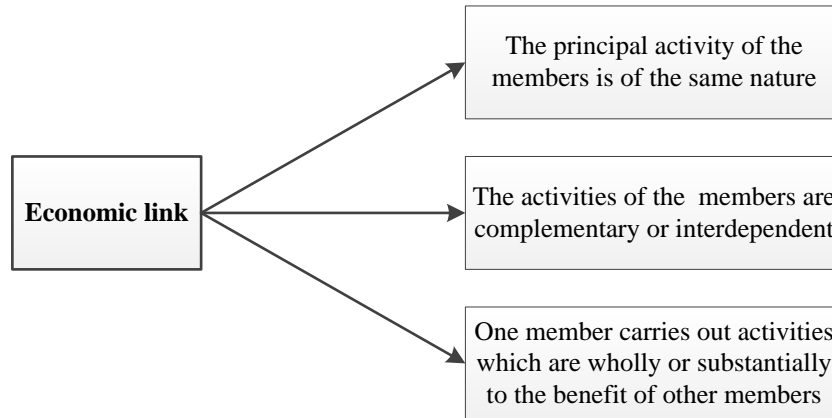
3.6. The economic link

3.6.1. Minimum content of the economic link test

According to the Commission's Communication, the economic link could be defined by reference to the existence of at least one of the following circumstances of economic cooperation: (i) the principal activity of the group members is of the same nature; or (ii) the activities of the group members are complementary or interdependent; or (iii) one member of the group carries out activities which are wholly or substantially to the benefit of the other members. It is worth noting that the disparity of possible scenarios makes it difficult to give a one-dimensional answer that can cover all such scenarios.

³⁵ F. Lafontaine and K. L. Shaw, "The Dynamics of Franchise contracting: evidence from panel data", *Journal of Political Economy*, Vol. 107, No 5, 1999, p. 1042.

³⁶ *Ibid.*



This would preclude artificial structures of entities devoid of any economic significance to be treated as a single taxable person. If entities whose economic activities are completely unrelated were allowed to form a VAT group, the economic link requirement laid down in Article 11 of the VAT Directive would become meaningless.

As regards the first scenario, an economic link would seem to exist if the activities of the VAT group members are of the same kind even where carried out in different economic sectors (e.g. auditing services).

The activities of the members being complementary or interdependent, as set out in the second scenario, may cover cases where the goods or services produced by a VAT group member are necessary for another member's activities (e.g. a company producing auto parts for a car manufacturer); and cases where the goods or services are jointly consumed (e.g. a VAT group member supplying after sales customer services of products sold by another member). Some may think of franchise contracts as an example of cases where the activities of two or several persons are interlinked (see section 3.5.2.3).

The third scenario, which refers to the activities of VAT group members being wholly or partially to the benefit of other members, may cover cases where a company directly supplies goods or services to another, even if the activity of the latter is not necessarily dependent upon the input received (e.g. administrative support services).

Certain situations could be seen as failing to pass the economic link test. For instance, it seems difficult to see how this test could be met in a scenario involving companies operating in different economic sectors or where the activity of such entities is completely unrelated. In contrast, if their activities were of the same nature, complemented one another or the output was directly used by the other undertakings, they could be said to be closely bound by an economic link despite them belonging to different economic sectors.

3.6.2. *What are the features of such an economic link?*

For two persons to be seen as closely bound to one another by an economic link, it seems that they would have to carry out an activity, and that such activity would have to meet at least one of the three conditions outlined above.

In turn, Article 9 of the VAT Directive sets out the conditions for qualifying as a taxable person. It does so based on there being an economic activity which is carried out independently. Hence, it may be useful to clarify the relationship between the economic

link as set out for the purposes of Article 11 of the VAT Directive, and the concept of economic activity referred to in Article 9 of that Directive.

The economic link in Article 11 of the VAT Directive could not be taken to require that the activities of all VAT group members have to qualify as "economic activities" for the purposes of Article 9 of the VAT Directive. That would exclude non-taxable persons who despite being characterised by failing the requirements laid down in Article 9 of the VAT Directive are nevertheless eligible to form a VAT group³⁷. Notably, an entity may not qualify as a taxable person for VAT purposes as a consequence of lacking to carry out an economic activity, having an economic activity without it being carried out independently, or other reasons (e.g. public bodies which are regarded as non-taxable persons pursuant to Article 13 of the VAT Directive).

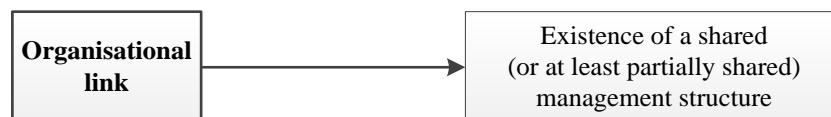
Although non-taxable persons may be allowed to join a VAT group and also admitting that the test in Article 9 of the VAT Directive is probably too narrow to apply as regards the economic link of VAT group members, it nonetheless seems difficult to see how certain persons who qualify as non-taxable persons because they have no activity at all (e.g. private individuals) could be seen as closely bound by an economic link to other persons.

Moreover, the activities individually carried out by each of the persons making up a VAT group to be looked at in order to assess the existence of an economic link (which, as stated above, should not necessarily have to qualify as "economic activities") should be distinguished from the activities carried out by the VAT group as a whole (which should qualify as "economic activities"). In this respect, according to the CJEU, once a VAT group is formed and only one single taxable person exists, that single taxable person must carry out an economic activity for the purposes of Article 9 of the VAT Directive: "*A comparison of those two provisions [Article 9 and Article 11 of the VAT Directive] does not preclude the interpretation that (...) it is those persons, taken together and closely bound to one another by financial, economic and organisational links, who must collectively satisfy that definition*"³⁸.

3.7. The organisational link

3.7.1. Minimum content of the organisational link test

According to the Commission's Communication, the organisational link could be defined by reference to the existence of a shared, or at least a partially shared, management structure.



³⁷ *Commission v Ireland*.

³⁸ *Commission v Ireland*, paragraph 45.

Fully or partially sharing a management structure would, in that sense, refer to the fact that the decision-making role in the VAT group lies fully or partly with one and the same entity, which provides strategic leadership³⁹ for the whole of the single taxable person.

It seems that the presence of such a management entity operating transversally across the VAT group could be established based on its level in the hierarchy (e.g. shared top management); or the nature of the activities on which it decides (e.g. shared management of legal affairs, or of financial issues).

To consider that a decision-making capacity has actually been implemented, it seems that the management entity should be able to impose its will, with the other VAT group members being subject to some form of supervision and accountability. This idea of supervision and dependency from a functional point of view may also be drawn from some of the existing case-law.

For instance, in *DFDS*⁴⁰, the CJEU concluded that an entity with its own legal personality was not to be treated as a taxable person independent from its parent company for VAT purposes. Notably, this conclusion stemmed from the existence of an agency agreement between the two entities in the case (a parent and a subsidiary company) and the various contractual obligations imposed on the subsidiary by its parent.

The Advocate General was even more precise in explaining that the closeness of the two entities from the functional perspective precluded them from being treated as independent: *"As the agency agreement defines the relations between the parent company and the subsidiary, the latter has no effective independence from the former in the conduct of its business. The same conclusion follows from a number of points made earlier: in particular, the need for prior approval from the parent company regarding management of the subsidiary company, such as the appointment of senior staff, the conclusion of major contracts, the appointment of advertising and public relations agents, and the lack of any discretion in setting the prices of services"*⁴¹.

This case would reflect the idea that undertakings subject to the decision-making capacity of one person (i.e. persons with at least a partly shared management structure) are not to be treated as independent persons.

In view of that, it could be considered whether franchise contracts should be taken as an example of a case where there is an organisational link, rather than it being set up as a presumption for the existence of the financial link (see section 3.5.2.3).

It must be noted that the control exercised by one of the parties of a franchise contract is not necessarily based on any financial relationship (other than the payment of franchise fees) but rather seems to be founded on the management characteristics of the contract. In this respect, it seems to be common for a franchisor to play an important role in the management of a franchisee: *"the franchisee obtains operations manual from the*

³⁹ See J. Black, N. Hashimza and G. Myles, "A Dictionary of Economics: management", Oxford University Press, 2013.

⁴⁰ Judgment of 20 February 1997, *Commissioners of Customs and Excise v DFDS*, C-260/95, EU:C:1997:77.

⁴¹ Opinion of Advocate General La Pergola of 16 January 1997, *Commissioners of Customs and Excise v DFDS*, C-260/95, EU:C:1997:20, point 22.

franchisor. The operation manual should explain how to run every aspect and operation of the business. This involves the day-to-day operation of the business. They should be in the form of a written manual which includes the details of what they are doing and how they should best be done"⁴².

3.8. Conclusions

Since the publication of the Commission's Communication, several judgments by the CJEU may be seen as having had an impact on the interpretation of the "financial, economic and organisational links" requirement pursuant to Article 11 of the VAT Directive.

Financial link

- It could be argued that the judgment of the CJEU in *Larentia + Minerva* precludes defining the necessary conditions which must be met for two or more persons to be closely bound by a financial link by reference merely to the notion of control of one company over another and the existence of a parent-subsidiary relationship. Moreover, since the CJEU has found in *Commission v Ireland* that non-taxable persons may become VAT group members, it is necessary to establish the meaning of "financial link" by allowing for criteria other than participation in capital or in voting rights.
- While the situations outlined in the Commission's Communication could still serve as presumptions of cases where the financial link requirement is met, it seems that the minimum content of the financial link would need to be agreed upon. As regards the minimum content of the financial link test, it could be based on one of the two options below (or a combination of both):

Option 1: two persons would be closely bound by a financial link where one person has substantial financial rights or liabilities in respect of the other, or has a substantial participation in the equity of the other (in the case of companies); or where such a person has substantial financial rights and/or liabilities in respect of the other (in the case where VAT group members are not companies).

Option 2: two persons would be closely bound by a financial link where they are financially dependent, that is, where one of them is not acting independently from the other financially speaking and, therefore, his financial risk is not mainly borne by himself but by the other person.

- For the sake of legal certainty, presumptions could be established, based on the content of the Commission's Communication:

Presumption 1: participation in another company (over 50%), on the basis of one of the two alternative options below:

Option 1: participation in the capital or in voting rights of another undertaking.

⁴² T. Luangsuwimol and B. H. Kleiner, "Effective franchise management", Management Research News, Vol. 27, 2004, p. 65.

Option 2: participation in voting rights only, which seems to have the same effects as the option 1 above.

Irrespective of which option is favoured, the participation could in principle be direct or indirect. However, doubts may arise in cases of direct participation where the parent company is not a VAT group member and in cases where the indirect participation does not amount to more than 50% (of capital or voting rights) in the indirectly controlled subsidiary.

Presumption 2: groups presenting consolidated financial statements pursuant to Directive 2013/34/EU.

Presumption 3: franchise contracts, although it may be that such a contract should perhaps rather be taken as an example of cases where an economic and/or an organisational link are present.

Economic link

- As stated in the Commission's Communication, the economic link could be defined by reference to the existence of at least one of the following situations of economic cooperation: (i) the principal activity of the group members is of the same nature; or (ii) the activities of the members are complementary or interdependent; or (iii) one member of the group carries out activities which are wholly or substantially to the benefit of other members.
- Although the activities of the members could not be required to qualify as an economic activity pursuant to Article 9 of the VAT Directive, as that would exclude non-taxable persons from becoming VAT group members, it is difficult to imagine how non-taxable persons having no activity at all could be seen as closely bound by an economic link to other members of a VAT group.

Organisational link

- As outlined in the Commission's Communication, the organisational link could be defined by reference to the existence of a shared, or at least partially shared, management structure.
- Such a management structure could be understood as requiring that the decision-making role in the VAT group lies fully or partly with the same entity. That decision-making entity could be defined according to its level in the hierarchy, or on the basis of a topic division.

4. DELEGATIONS' OPINION

The delegations are requested to give their opinion on the issues raised.

*

* *