



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

**taxud.c.1(2015)4500631 – EN**

Brussels, 30 September 2015

**VALUE ADDED TAX COMMITTEE**  
**(ARTICLE 398 OF DIRECTIVE 2006/112/EC)**  
**WORKING PAPER NO 883**

**QUESTION**  
**CONCERNING THE APPLICATION OF EU VAT PROVISIONS**

**ORIGIN:** Commission

**REFERENCE:** Article 132(1)(f)

**SUBJECT:** Scope of the exemption for cost-sharing arrangements:  
a further analysis (II)

## **1. INTRODUCTION**

In a renewed attempt to reach a common understanding as regards the exemption for cost-sharing arrangements provided for in Article 132(1)(f) of the VAT Directive<sup>1</sup>, the item was at the initiative of the Commission services put on the agenda of the 104<sup>th</sup> VAT Committee meeting, held in June 2015.

From discussions on the paper presented<sup>2</sup>, it seemed that Member States shared some of the views and concerns expressed by the Commission services but other aspects of the exemption proved more controversial, and hence the need to examine the issue further. Apart from elaborating on some controversial points, this paper also covers questions raised during the meeting, which were not specifically dealt with in the previous analysis.

## **2. SUBJECT MATTER**

Article 132(1)(f) of the VAT Directive provides an exemption for cost-sharing arrangements, whereby Member States shall exempt:

*"... (f) the supply of services by independent groups of persons, who are carrying on an activity which is exempt from VAT or in relation to which they are not taxable persons, for the purpose of rendering their members the services directly necessary for the exercise of that activity, where those groups merely claim from their members exact reimbursement of their share of the joint expenses, provided that such exemption is not likely to cause distortion of competition".*

The purpose of this exemption is to allow economic operators use a cost-sharing group to pool the acquisition of services and re-distribute the costs for these services exempt from VAT, from the group to its members. In order for the exemption to apply, Article 132(1)(f) of the VAT Directive lays down five conditions to be met:

1. there must be an entity<sup>3</sup> ("independent group") supplying services to persons who are members of it;
2. the members must be either taxable persons carrying on a downstream activity which is exempt from VAT or out of scope or non-taxable persons;
3. the services supplied by the group must be "directly necessary" for the exercise of the members' exempt or non-taxable downstream activities;
4. the services supplied by the independent group must be rewarded at cost ("exact reimbursement") and so the group must not make a profit out of the exempt services supplied to its members;
5. the exemption from VAT of the supplies must not be likely to cause distortion of competition.

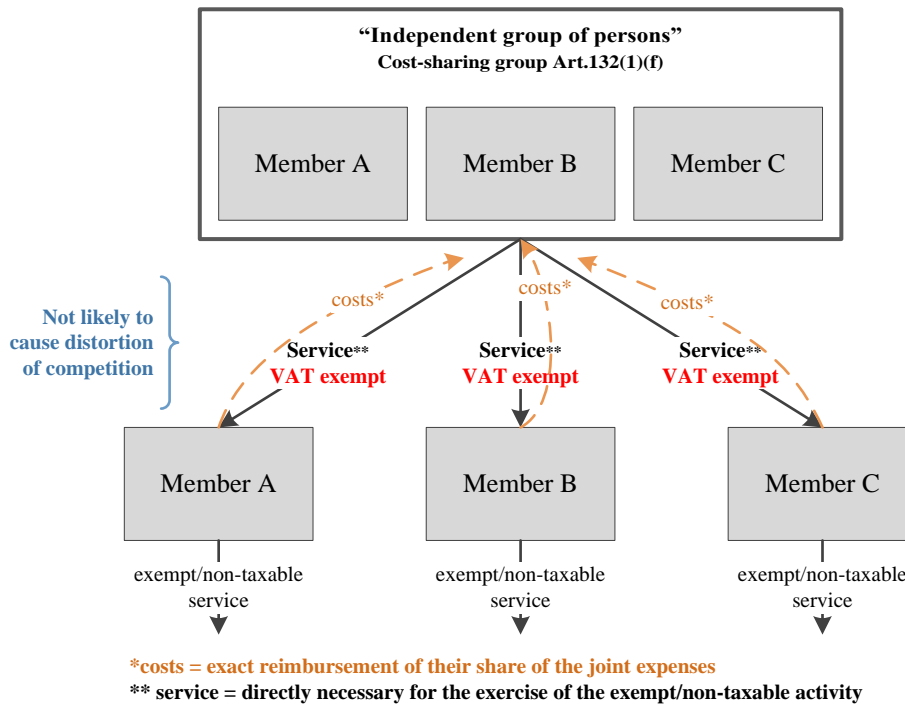
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<sup>1</sup> Council Directive 2006/112/EC of 28 November 2006 on the common system of value added tax (OJ L 347, 11.12.2006, p. 1).

<sup>2</sup> Working paper No 856.

<sup>3</sup> This entity is often referred to as a "cost-sharing group" or "cost-sharing association". The CJEU has also used the term "umbrella organisation". In this respect, see CJEU, judgment of 15 June 1989 in case 348/87 *Stichting Uitvoering Financiële Acties*, paragraph 15.

This can be illustrated as such:



### 3. THE COMMISSION SERVICES' OPINION

#### 3.1. Scope of the present analysis

##### 3.1.1. Recent discussions

The most recent discussion in the VAT Committee covered the topic from a broader perspective; and also looked at the application of the exemption in cross-border situations and its interaction with the VAT grouping provisions.

##### 3.1.2. Focus of this discussion

Picking up from the discussions already had, it is apparent that more clarification is needed on certain aspects of Article 132(1)(f) of the VAT Directive, notably concerning the conditions laid down in the provision for its application<sup>4</sup>. In this respect, for example, it should be clarified whether a cost-sharing group can benefit from exemption when it provides to its members services obtained from third parties, and also whether it could have profits in respect of services provided to non-members. Another issue that poses many challenges is the application of this exemption in cross-border scenarios.

Briefly, the present analysis covers the following:

- Aspects related to some of the conditions for the cost-sharing arrangement exemption to apply;
- Application of the exemption in cross-border scenarios within the EU;
- Aspects related to VAT groups; and

<sup>4</sup> To avoid duplication, only those of the issues which seemed controversial have been elaborated further.

- Final considerations.

**I. Aspects related to some of the conditions for the cost-sharing arrangement exemption to apply**

**3.2. Condition 1: There must be an entity ("independent group") supplying services to persons who are members of it**

*3.2.1. Must a cost-sharing group be an entity with legal personality?*

As previously stated<sup>5</sup>, although Article 132(1)(f) of the VAT Directive is silent as to the characteristics, from a legal perspective, that a cost-sharing group needs to have, it seems clear that (i) the group must be made up of several persons intending to share the costs of the services received, and that (ii) it must be an autonomous entity different from its members – as opposed to cost-sharing groups formed by means of contractual arrangements.

The question is however whether this independent entity must also have legal personality<sup>6</sup>. This separate legal personality results in an incorporated entity being treated in law as having its own legal rights and obligations, just as individuals.

In this respect, it does not stem from the wording of Article 132(1)(f) of the VAT Directive nor from the purpose of the exemption itself that having legal personality is a requirement to be met by the cost-sharing group. In fact, it seems that some entities could be considered to be independent and qualify as taxable persons in their own right for VAT purposes, while having no legal personality (for example, a civil partnership). The lack of legal personality should not prevent such entities from acting as a cost-sharing group.

*3.2.2. Can a person making up the entity which operates as a cost-sharing group be excluded from membership for VAT purposes?*

The question is whether all of those making up the entity used as a cost-sharing group must be considered to be members of that group for the purposes of applying the exemption pursuant to Article 132(1)(f) of the VAT Directive. In other words, whether it is possible to argue, for example, that a shareholder of a company acting as a cost-sharing group is to be considered not to be a member of that cost-sharing group for VAT purposes.

This question comes out of the twofold perspective from which a cost-sharing structure can be looked at: the legal and the VAT perspectives.

As regards the application of the exemption, it must be borne in mind that any person wishing to benefit therefrom must be a member of the cost-sharing group and, therefore, "belong" as a member to that entity. This does not, however, mean that every person making up such an entity can benefit from the exemption, since the rest of the conditions laid down in Article 132(1)(f) of the VAT Directive must be observed. This is in line with our analysis that each supply of services made by the cost-sharing group to a member

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<sup>5</sup> Working paper No 856 (sections 3.1.1 and 3.1.2).

<sup>6</sup> Entities with legal personality are often referred to as "legal entities".

needs to be looked at separately<sup>7</sup>: being a member of a cost-sharing group is a condition necessary but not sufficient in itself for being able to receive exempt services.

However, it is something different to outright exclude for VAT purposes a party legally making up an entity used as a cost-sharing group. The Commission services believe that such exclusion could lead to cumbersome scenarios.

In particular, where a person integrates the entity used as a cost-sharing group and in turn receives services from that cost-sharing group in accordance with the requirements governing the exemption in the VAT Directive, it is difficult to see how that person can be said not to be a member of the cost-sharing group for VAT purposes and so not entitled to receive exempt supplies, albeit meeting all the conditions for exemption to apply pursuant to Article 132(1)(f) of the VAT Directive.

As to the reasons for possibly wanting such exclusion, some may think this is needed when some parties intending to pool resources wish to make use of an existing entity as a cost-sharing group, and that existing entity is made up not only by such parties but also by others. However, the fact that in legal terms the cost-sharing group is integrated by different parties, some of which may not wish to share costs, would not seem to prevent exemption being applied in regard to the transactions which meet the requirements of the VAT Directive.

*3.2.3. Can natural persons who are not self-employed be members of a cost-sharing group?*

From a legal perspective, the wording of Article 132(1)(f) of the VAT Directive simply states in respect of members of cost-sharing groups that they need to be "persons" which could include natural or legal persons, in any legal form<sup>8</sup>.

The CJEU confirmed this fact in *Bulthuis-Griffioen*<sup>9</sup> in general for the exemptions of Article 132(1) of the VAT Directive, saying that: "*Certain of the exemptions mentioned in Article 13A(1) of the Sixth Directive, including the one provided for in paragraph (g) of that provision, expressly refer to the concept of 'body' or 'organization', whereas others do not. The position is, therefore, that in the former case the exemption may be claimed only by legal persons whereas in the latter case it may also be claimed by natural persons including traders*".

Later on, in its judgment in *Gregg* the CJEU took an even broader approach, by stating that the wording of exemptions (and any explicit reference made to different categories of economic operators) must not preclude natural persons from applying them<sup>10</sup>.

Regarding natural persons in the frame of cost-sharing arrangements, it seems *a priori* that the vast majority of those eligible for becoming members of a cost-sharing group would be self-employed, given that the members are required to carry on a downstream activity which is exempt from VAT or in relation to which they are not taxable persons.

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<sup>7</sup> Working paper No 856 (section 3.1.11).

<sup>8</sup> Working paper No 856 (section 3.1.3).

<sup>9</sup> CJEU, judgment of 11 August 1995 in case C-453/93 *Bulthuis-Griffioen*, paragraph 20.

<sup>10</sup> CJEU, judgment of 7 September 1999 in case C-216/97 *Gregg*, paragraph 15.

Self-employment is the act of generating one's income directly from customers, as opposed to being the employee of a business or another person. If the natural person being a member of a cost-sharing group was an employee (and not a self-employed person), this person would be acting in the name of his employer and, as a consequence, it would be the latter who had to be seen as the member of the cost-sharing group.

Having said so, it must be noted that there could also be the case of a natural person carrying on a voluntary and unpaid activity – and, therefore, not being self-employed. It seems that, under such circumstances, the exemption under Article 132(1)(f) of the VAT Directive should be available provided, however, that all the conditions are met, thereby allowing the volunteer to receive exempt services from a cost-sharing group which are necessary for the exercise of his activity.

*3.2.4. Can Member States exclude non-taxable persons from becoming members of a cost-sharing group?*

As previously stated<sup>11</sup>, it seems clear from the very wording of Article 132(1)(f) of the VAT Directive that both taxable and non-taxable persons are eligible as members of a cost-sharing group. The question is however whether Member States could exclude non-taxable persons from becoming members of a cost-sharing group.

This question was already examined by the Commission services in regard to VAT groups<sup>12</sup>. In this respect, reference must be made to the judgment *Commission v. Ireland*, where the CJEU pointed out that if "*...the possibility for Member States to regard as a single taxable person a group of persons including one or more persons who may not individually have the status of a taxable person (...) might itself give rise to abuse, the second paragraph of Article 11 of the VAT Directive permits Member States to adopt any measures needed to prevent tax evasion or avoidance through the use of the first paragraph of Article 11*"<sup>13</sup>.

In *Commission v. Sweden*<sup>14</sup>, the CJEU also confirmed that Member States can – as a measure to prevent tax evasion or avoidance – restrict the scope of application of that provision to certain business sectors: "*The second paragraph of Article 11 of the VAT Directive also permits Member States to adopt any measures needed to prevent tax evasion or avoidance through the use of the first paragraph of the article. Such measures may, however, be taken only in compliance with European Union law. Thus, with that reservation, it is permissible for Member States to restrict the application of the scheme provided for under Article 11 to combat tax evasion or avoidance*".

For cost-sharing groups, an analogous approach could perhaps be adopted. Indeed, Article 131 of the VAT Directive contains an anti-abuse clause in respect of certain exemptions provided for under the VAT Directive: "*The exemptions provided for in Chapters 2 to 9 shall apply without prejudice to other Community provisions and in accordance with conditions which the Member States shall lay down for the purposes of ensuring the correct and straightforward application of those exemptions and of preventing any possible evasion, avoidance or abuse*".

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<sup>11</sup> Working paper No 856 (section 3.1.3).

<sup>12</sup> Working paper No 813 (section 3.2).

<sup>13</sup> CJEU, judgment of 9 April 2013 in case C-85/11 *Commission v. Ireland*, paragraphs 48 and 49.

<sup>14</sup> CJEU, judgment of 25 April 2013 in case C-480/10 *Commission vs. Sweden*, paragraph 38.

That could be taken to allow Member States to restrict the scope of the exemption for cost-sharing arrangements by excluding non-taxable persons from joining a cost-sharing group, as a measure to prevent abuse and tax evasion.

However, account should also be taken of the doctrine of the CJEU<sup>15</sup> in respect of the limits of Article 131 of the VAT Directive, according to which measures taken on that basis cannot affect the definition of the subject-matter of the exemptions envisaged, *i.e.*, the question whether a specific transaction is taxed or exempt from VAT cannot depend on its classification in national law.

Unlike Article 11, Article 132(1)(f) of the VAT Directive expressly foresees in its wording that non-taxable persons can be members of a cost-sharing group<sup>16</sup>. Excluding such persons from the scope of the exemption could be seen as effectively altering the content of the provision and unduly restricting its applicability.

In consequence, and without prejudice to situations where specific reasons might justify such exclusion on the grounds of preventing tax avoidance or abuse, the Commission services believe that it is necessary to exercise this anti-abuse clause with care.

*3.2.5. May a cost-sharing group provide (i) exempt services to those of its members meeting the conditions laid down in Article 132(1)(f) of the VAT Directive; and (ii) taxed services to other members not meeting those conditions?*

As already indicated<sup>17</sup>, it seems that each supply of services made by the cost-sharing group to a member would need to be looked at separately. Thus, the VAT treatment of the services supplied by a cost-sharing group to its members could differ, depending on whether or not the member individually fulfils the conditions laid down in Article 132(1)(f) of the VAT Directive.

Requiring all of the services supplied by the cost-sharing group to qualify for exemption appears restrictive and no such requirement is envisaged by the provision as worded nor is it possible to be drawn from an interpretation of that provision.

*3.2.6. Can a cost-sharing group exempt the services that it provides to its members, where such services have been obtained from third parties?*

The question is whether the exemption should be limited to the provision by a cost-sharing group to its members of in-house services (activities conducted within the cost-sharing group, carried out by making use of its own resources), or whether the exemption could also be applicable to bought-in services (obtained from third parties) which are subsequently provided by the cost-sharing group to its members.

Article 132(1)(f) of the VAT Directive simply requires the supply of services to be made by a cost-sharing group but no reference is made as to the origin of the services provided to its members. This would seem to indicate that there must be no distinction made

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<sup>15</sup> CJEU, judgment of 21 March 2013 in case C-197/12 *Commission v. France*, paragraph 31; CJEU, judgment of 18 October 2007 in case C-97/06 *Navicon*, paragraphs 27 and 28; CJEU, judgment of 22 December 2010 in case C-116/10 *Bacino Charter*, paragraph 20.

<sup>16</sup> "...the supply of services by independent groups of persons, who are carrying on an activity which is exempt from VAT or in relation to which they are not taxable persons...".

<sup>17</sup> Working paper No 856 (section 3.1.11).

between bought-in services and services produced in-house, and that exemption for the supply of services obtained from third parties could only be denied on account of not meeting other conditions.

Although the CJEU has repeatedly stressed that the exemptions in the VAT Directive are to be interpreted strictly, since they constitute exceptions to the general principle that VAT is to be levied on all services supplied for consideration by a taxable person<sup>18</sup>, it should not be so that a narrow interpretation limits the scope of an exemption beyond the wording of the provision so contained.

Therefore, if all the conditions of Article 132(1)(f) of the VAT Directive are met, the application of this exemption should be possible in circumstances which are not explicitly excluded by the wording of that provision.

- *Provider of the services*

First, it must be determined whether a cost-sharing group acquiring services from a third party for its members can be seen as the provider of those services, given that one of the requirements of Article 132(1)(f) of the VAT Directive is that the supply of services must be made by the cost-sharing group.

The cost-sharing exemption is available only for supplies of services, which would typically be provided directly to the final recipient of that service. In this regard, it is likely that outsourced services could be provided by the third party in the name of the cost-sharing group directly to the member of that group, in which case the abovementioned condition would be met.

The CJEU has not addressed this issue in a direct manner, but reference should be made to *SUFA*<sup>19</sup>, due to the resemblance of the facts dealt with<sup>20</sup>. In that case, a foundation ("SUFA") organised and held lotteries on behalf of another foundation ("ALN") which distributed the proceeds amongst a certain number of social and cultural institutions affiliated to it. ALN was considered to be a cost-sharing group, and given that the conditions laid down in Article 132(1)(f) of the VAT Directive were met, the services rendered by ALN to its members were exempted. The question was whether the services supplied by SUFA to ALN could also be seen as provided by a cost-sharing group and thus exempted.

The CJEU in this case concluded that it was not possible to exempt the services provided by SUFA (alleged to be a cost-sharing group) to ALN (in itself a cost-sharing group), on the grounds that neither foundation was a member of the other and this is a requirement in order for Article 132(1)(f) of the VAT Directive to apply. It should be noted that the fact that the cost-sharing group (ALN) was outsourcing services to a third party (SUFA), which is precisely the scenario hereby examined, was not challenged.

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<sup>18</sup> CJEU, judgment of 19 July 2012 in case C-44/11 *Deutsche Bank*, paragraph 42 and the case-law cited.

<sup>19</sup> CJEU, judgment of 15 June 1989 in case 348/87 *Stichting Uitvoering Financiële Acties (SUFA)*, paragraph 15.

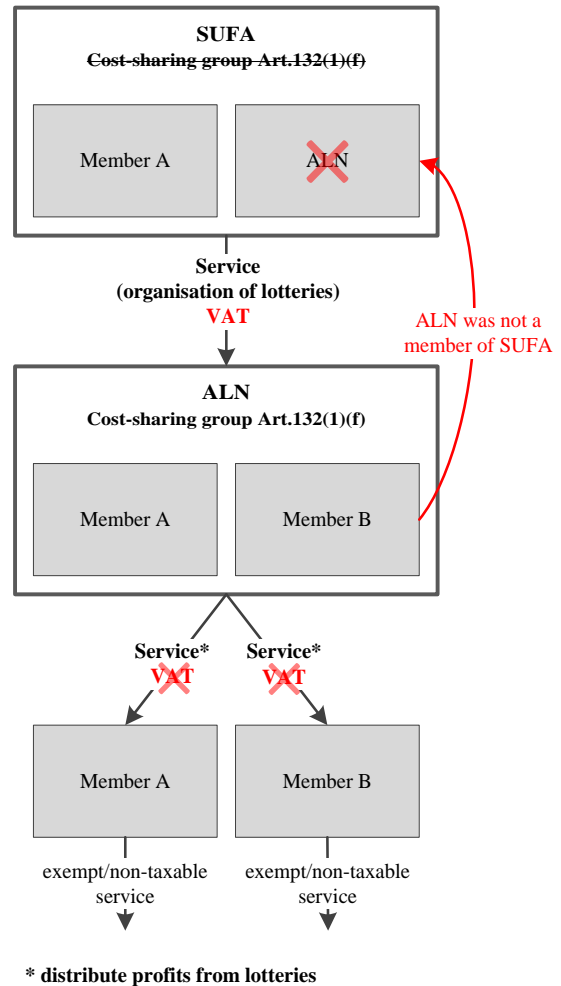
<sup>20</sup> The question examined in this section is slightly different from the case facts at hand in *SUFA*, since it is now assumed that the services obtained from a third party by the cost-sharing group to be supplied on to its members are taxed, unless another exemption applies.



From this, it seems to follow that, had all the conditions laid down in Article 132(1)(f) of the VAT Directive been met, the exemption should have been available not only to services provided by ALN to its members (irrespective of whether these had been supplied in-house or outsourced to a third party), but also to the services provided by SUFA to ALN.

It could also be drawn from *SUFA* that the application of the exemption by a cost-sharing group should not be conditional on the origin of the services received by its members (internal or external), since this was an aspect not challenged by the parties of the procedure, nor by the CJEU itself.

In consequence, if all the conditions required for the cost-sharing exemption to apply are met, exemption for the supply made to members should be available regardless of the fact that the services provided by the cost-sharing group may have been outsourced.



- *Impact in terms of VAT revenue and cost for the recipients of the services*

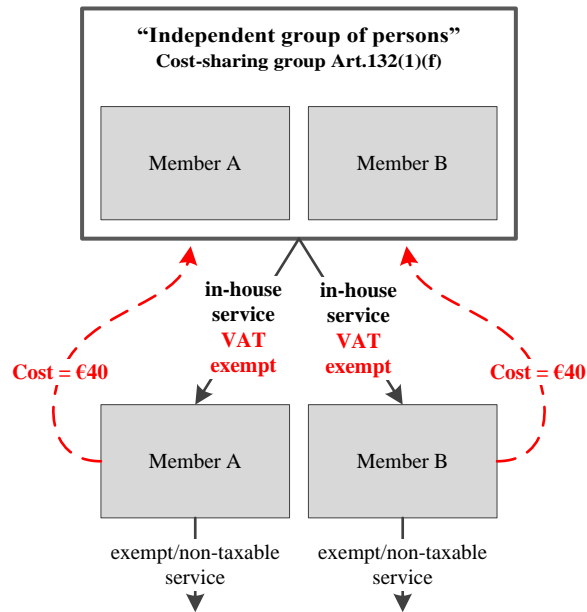
Secondly, applying the exemption to bought-in services distributed by the cost-sharing group to its members does not seem to lead to any abusive situation, impacting on VAT revenue or the cost for the recipients of the services.

In order to illustrate this point, three scenarios are presented allowing a straightforward comparison<sup>21</sup>: Scenario 1 reflects the standard case where a cost-sharing group provides in-house services to its members; scenario 2 is an example of outsourced services provided directly by a third party to a company; and scenario 3 describes outsourced services provided by a third party to a company via a cost-sharing group.

<sup>21</sup> As can be seen in the examples, we have assumed that the cost of in-house services would typically be lower (scenario 1) than that of bought-in services (scenarios 2 and 3); and that the members of the cost-sharing group have the same share of the joint expenses.

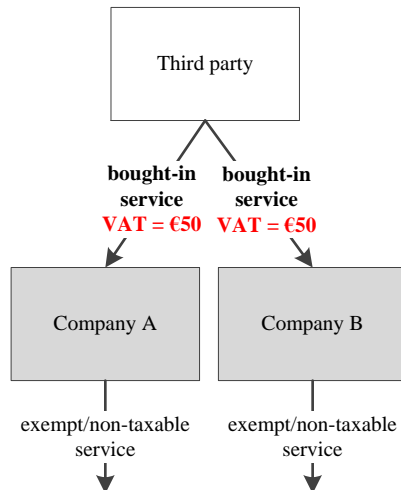
**Scenario 1**

*In-house services generated  
and provided by a cost-  
sharing group*



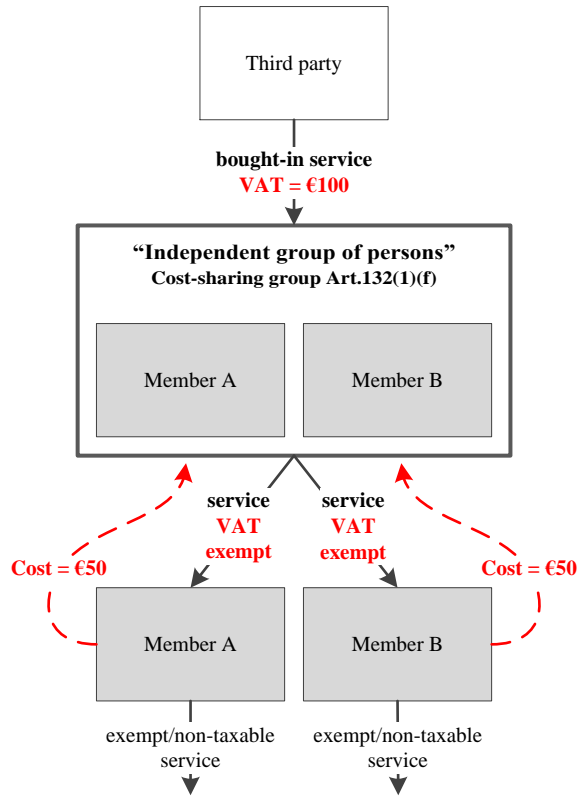
**Scenario 2**

*Outsourced services directly  
provided by a third party to a  
company*



**Scenario 3**

*Outsourced services provided by a third party  
to a company via a cost-sharing group  
(if the exemption applies)*



As can be seen from the diagrams, the case where services provided by a third party to a company via a cost-sharing group with the exemption applying (scenario 3) seems equivalent to that where services are directly provided by a third party to a company (scenario 2), with the same outcome in terms of VAT revenue and cost for the recipient of the services. If the services received from the third party had been exempt, this would still hold true.

The purpose of the exemption is allowing members of a cost-sharing group to achieve economies of scale, thus ensuring a level playing field with larger competitors which have the capacity to undertake the same activities internally<sup>22</sup> (scenario 1, as compared to scenario 2). So, although it is unclear which the incentives are for obtaining externally-purchased services via a cost-sharing group (scenario 3), there seems to be no good reason for excluding the application of the exemption in such circumstances on the grounds of abuse, since scenario 3 confers no tax advantage on members of the cost-sharing group.

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<sup>22</sup> In the same line, see CJEU, opinion of Advocate General Mischo in case C-8/01 *Taksatorringen*, points 118 and 119.

**3.3. Condition 2: Members of the independent group must be either taxable persons carrying on a downstream activity which is exempt from VAT or out of scope or in relation to which they are not taxable persons**

*3.3.1. Which should be the practical application of the exemption if members of a cost-sharing group who are taxable persons also carry on taxed activities?*

Given the absence of any indication in the wording of Article 132(1)(f) of the VAT Directive that the exemption is only for the use of groups whose members "exclusively" carry on exempt or non-taxable activities, the Commission services are of the opinion that there is no basis for applying such a restriction<sup>23</sup>.

Therefore, the exemption should be available for supplies of services – made by the cost-sharing group to a member – which are used for the exercise of exempt or non-taxable downstream activities by that member, irrespective of whether that member is also carrying on taxed activities.

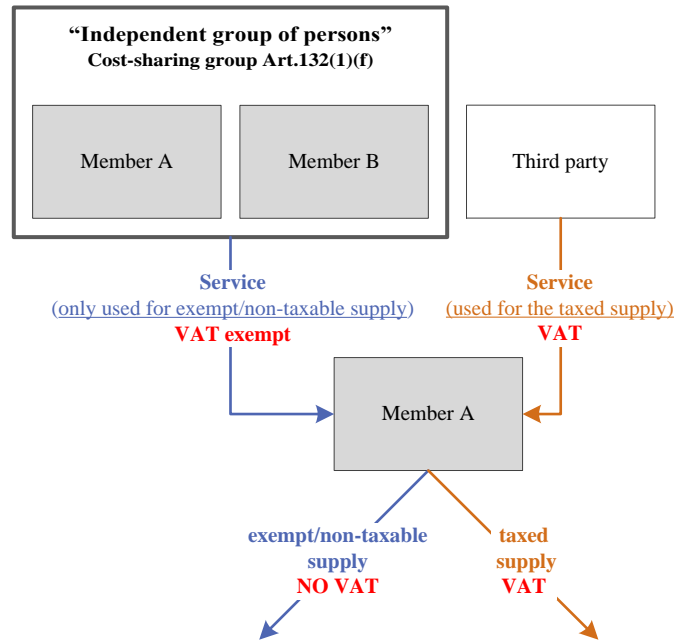
Below, an outline of the practical application of the exemption in two different scenarios: (i) one where the services provided by the cost-sharing group are used only for the exercise of exempt/non-taxable downstream activities by the member; and (ii) another where the services provided by the cost-sharing group are used for the exercise of both exempt/non-taxable and taxed downstream activities by the member.

- *Scenario 1: Services used only for the exercise of exempt/non-taxable downstream activities by the member of a cost-sharing group*

Where the services provided by the cost-sharing group to its member are allocated to the exempt or non-taxable downstream activities of that member and all the conditions of Article 132(1)(f) of the VAT Directive are met – notably, that the services provided by the group are directly necessary for those downstream activities – then the application of the exemption should not be problematic. Find below an example of this scenario.

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<sup>23</sup> Working paper No 856 (section 3.2.1).



- *Scenario 2: Services used for both exempt/non-taxable and taxed downstream activities by the member of a cost-sharing group*

There is certainly a risk that members of a cost-sharing group could try to take advantage of the tool provided for under Article 132(1)(f) of the VAT Directive to acquire exempt services from the cost-sharing group that would subsequently be used for taxed downstream activities – and not for exempt or non-taxable activities as required in Article 132(1)(f) of the VAT Directive. This scenario raises questions about the allocation of services between the different downstream activities of the member of a cost-sharing group and how to apply the exemption.

In this respect, it is necessary to keep in mind the reasoning behind the cost-sharing exemption and the implications thereof. Since the members of a cost-sharing group have no right of deduction – because they are supplying exempt or non-taxable services – the services received from the cost-sharing group are exempted. That is so in order for each member not to have to bear input VAT which is instead borne by the cost-sharing group itself. From an economic perspective, if the member of the cost-sharing group is carrying on taxed activities, and therefore has a right of deduction, the exemption of the services received by that member has little or no point.

Having said so, it must be stressed that the fact that the services supplied by a cost-sharing group may also be used for other (taxed) activities of the member of the cost-sharing group should not necessarily preclude the benefit of the exemption altogether. It does not follow from such "mixed use" that the services are not directly necessary for an exempt or non-taxable activity. Even if the exempt or non-taxable activity constitutes only a proportion of the activities carried on by the member, the services supplied could still meet the conditions of Article 132(1)(f) of the VAT Directive.

As to how to apply the exemption in such circumstances, three alternative options are presented below. Although none of the options provides for an optimal solution, the Commission services wish to stress that the availability of the exemption should not be ruled out merely because of cumbersome application.

– *Option A: Partial application of the exemption*

A partial application of the exemption seems an accurate solution from a theoretical perspective: the part of the services supplied by the cost-sharing group which is allocated to taxed downstream activities of the member does not meet the conditions laid down in Article 132(1)(f) of the VAT Directive, and should not be exempted; only the part of the services allocated to exempt or non-taxable downstream activities of the member meets the conditions for being exempt.

However, Article 132(1)(f) of the VAT Directive does not foresee a partial application of the exemption. It seems that the services supplied by a cost-sharing group to the member, which are used for both exempt/non-taxable activities and taxed activities, would need to be allocated to each of these two categories in order for the partial application of the exemption to be possible. To this effect, an option could be to use the pro-rata set out in the VAT Directive for the right of deduction, as shall be seen.

In general, exemptions for the supply of services are built around the characteristics of the economic activity, but are not dependent upon conditions being met subsequently. The exemption for cost-sharing arrangements is nonetheless made conditional upon the nature of the economic activities actually performed by the members of a cost-sharing group. In consequence, it is only once the economic activity of the member in question is carried out that the conditions for the application of Article 132(1)(f) of the VAT Directive can be assessed to the full extent.

This is similar to the functioning of the right of deduction for taxable persons, which is determined by the nature of the output transactions to which the input transactions are assigned. According to Article 168 of the VAT Directive, the right to deduct input VAT of a taxable person is conditional on the goods and services being used for the purposes of taxed transactions by that taxable person<sup>24</sup>. On the other hand, as confirmed by the CJEU<sup>25</sup>, where goods or services acquired by a taxable person are used for purposes of transactions that are exempt or do not fall within the scope of VAT, no output tax can be collected and, therefore, no input tax may be deducted.

Article 173 of the VAT Directive foresees a mechanism of proportional deduction: in case of goods or services used by a taxable person both for transactions in respect of which VAT is deductible pursuant to Articles 168, 169 and 170 of the VAT Directive, and for transactions in respect of which VAT is not deductible, only the proportion of the VAT attributable to the former transactions shall be deductible<sup>26</sup>. That proportion ("pro-rata") is made up of a fraction, pursuant to Article 174 of the VAT Directive, comprising (i) as numerator, the total amount, exclusive of VAT, of turnover attributable to transactions in respect of which VAT is deductible pursuant to Articles 168, 169 and 170; and (ii) as

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<sup>24</sup> As found by the CJEU, there must exist a direct and immediate link between a particular input transaction and a particular output transaction or transactions giving rise to entitlement to deduct. See among others CJEU, judgment of 8 June 2000 in case C-98/98 *Midland Bank*, paragraph 24; and CJEU, judgment of 22 February 2001 in case C-408/98 *Abbey National*, paragraph 266.

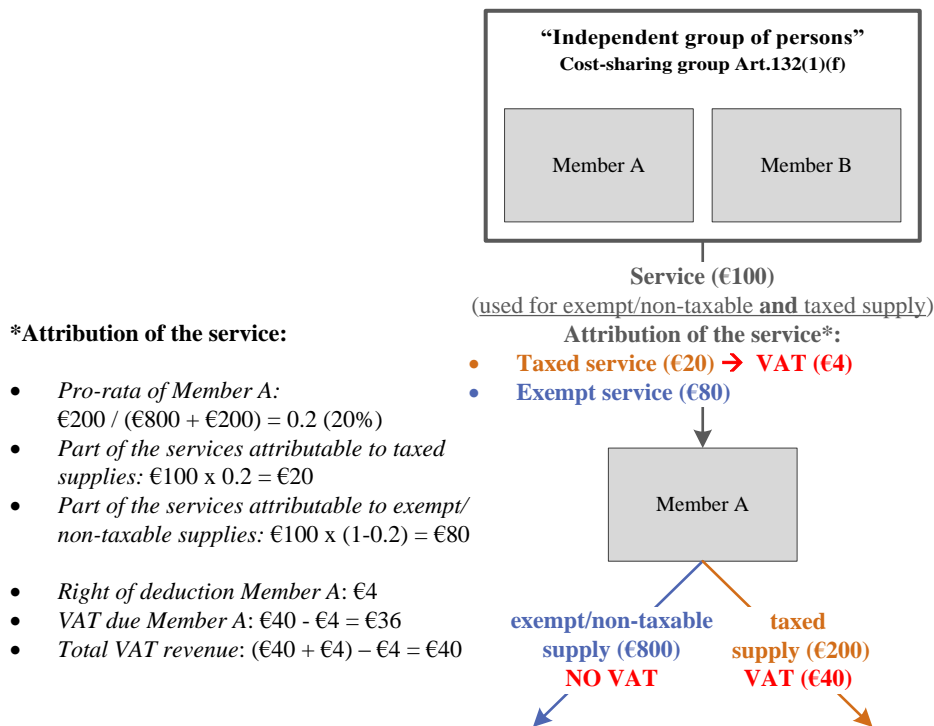
<sup>25</sup> CJEU, judgment of 29 October 2009 in case C-29/08 *SKF*, paragraphs 57 to 60.

<sup>26</sup> In these circumstances, the input VAT borne by the taxable person is considered to have a direct and immediate link with the taxable person's economic activity as a whole. See among others *SKF*, paragraph 58; *Midland Bank*, paragraphs 23 and 31; and *Abbey National*, paragraph 35.

denominator, the total amount, exclusive of VAT, of turnover attributable to transactions included in the numerator and to transactions in respect of which VAT is not deductible.

$$\text{pro – rata (right of deduction)} = \frac{\text{turnover (VAT deductible)}}{\text{total turnover}}$$

Concerning the application of exemption in the scenario at hand, the pro-rata of a member of a cost-sharing group could indicate which proportion of the services supplied by the cost-sharing group is attributable to the taxed transactions of the member. This way the proportion of services supplied by the cost-sharing group attributable to exempt or non-taxable activities carried on by the member could be deducted, which would then be the part that could be exempted pursuant to Article 132(1)(f) of the VAT Directive. An example is provided below.



### Considerations

First of all, this option could be challenged on the grounds that there is no clear basis in the VAT Directive for giving a different VAT treatment (exempt-taxed) to different parts of a single service, which is the one supplied by the cost-sharing group to its member. In this respect, note should be taken of the doctrine of the CJEU on the artificial split of a single service: *"it follows from Article 2(1) of the Sixth Directive that every supply of a service must normally be regarded as distinct and independent and, second, that a supply which comprises a single service from an economic point of view should not be artificially split, so as not to distort the functioning of the VAT system..."*<sup>27</sup>.

For two parts of the same single service to be treated differently from a VAT perspective also poses questions as to how the invoicing system would work, in particular whether

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<sup>27</sup> CJEU, judgment of 25 February 1999 in case C-349/96 *Card Protection Plan*, paragraph 29.

there should be two separate invoices issued, or just one invoice detailing the different VAT treatments.

Mention must be made of the additional administrative burden that charging VAT on part of the service would entail, despite the fact that input VAT would in any event be deductible for the member of the cost-sharing group concerned<sup>28</sup>.

Besides, the application of the exemption by the cost-sharing group would be dependent upon information obtained from a separate entity, that is, information from the member concerning its pro-rata. This could hamper the simple and straightforward application of the exemption.

The temporal aspect should also be taken into account. Due to the mechanics of the pro-rata, the latter would only be known at the end of the year, which seems to imply that a correction of the attribution of the service initially made for the purposes of applying the exemption would be needed.

Another consequence of partial application of the exemption is that, for the cost-sharing group, this option entails output VAT. According to Article 168 of the VAT Directive, the cost-sharing group would have a right of deduction in respect of its taxed transactions, that is, the proportion of the service supplied to the member which has been allocated to its taxed downstream activity.

– *Option B: Full application of the exemption*

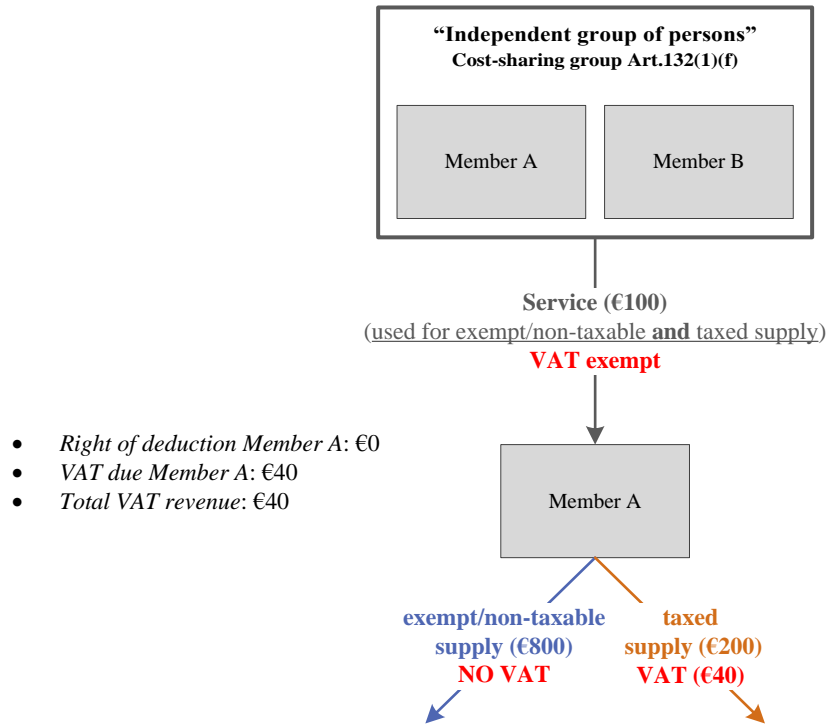
For the sake of simplification, another option could be to disregard the fact that the services provided by the cost-sharing group which are directly necessary for the exempt or non-taxable downstream activities of the member could also be used for the purposes of taxed activities of that member, in cases where the proportion of such taxed activities is relatively low compared to the total activity.

In practical terms, mixed taxable persons would then have to reach a certain threshold with regard to their exempt or non-taxable activities in order to be eligible for exemption. If they would not reach that threshold, no exemption would apply although the service supplied may be used primarily for the exempt or non-taxable activities of that mixed taxable person.

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<sup>28</sup> In this respect, it should be noted that the total VAT revenue does not vary compared to that under option B.





### Considerations

This option raises some problems linked to the fact that services supplied to the member of a cost-sharing group would be exempted, although these services could be in part allocated to taxed downstream activities.

First, even if these taxed activities may represent a small part of the member's business, it would still see services exempted which under normal circumstances should have been taxed. This could be seen as running against the general principle that the exemptions provided for under the VAT Directive are to be interpreted strictly, since they constitute exceptions to the general principle that VAT is to be levied on all services supplied for consideration by a taxable person<sup>29</sup>. Although under Article 131 of the VAT Directive Member States have some discretion in applying exemptions, extending the scope of the exemption would seem against the doctrine of the CJEU whereby the use of that provision cannot affect the content of the exemptions<sup>30</sup>.

Moreover, this option could lead to unduly exclude from the scope of the exemption mixed taxable persons who do not reach the threshold of exempt or non-taxable downstream activities set, that is, who carry on a majority of taxed activities. Although the proportion of taxed activities of a company may be superior to that of exempt or non-taxable activities, that does not in itself mean that the company is not eligible as a member of a cost-sharing group and able to benefit from the exemption in Article 132(1)(f) of the VAT Directive, notably in respect of the services used exclusively for its exempt or non-taxable activities.

This option would also require setting the exact proportion of taxed activities by the member of a cost-sharing group, out of the total business of that member. Differences in

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<sup>29</sup> *Deutsche Bank*, paragraph 42 and the case-law cited.

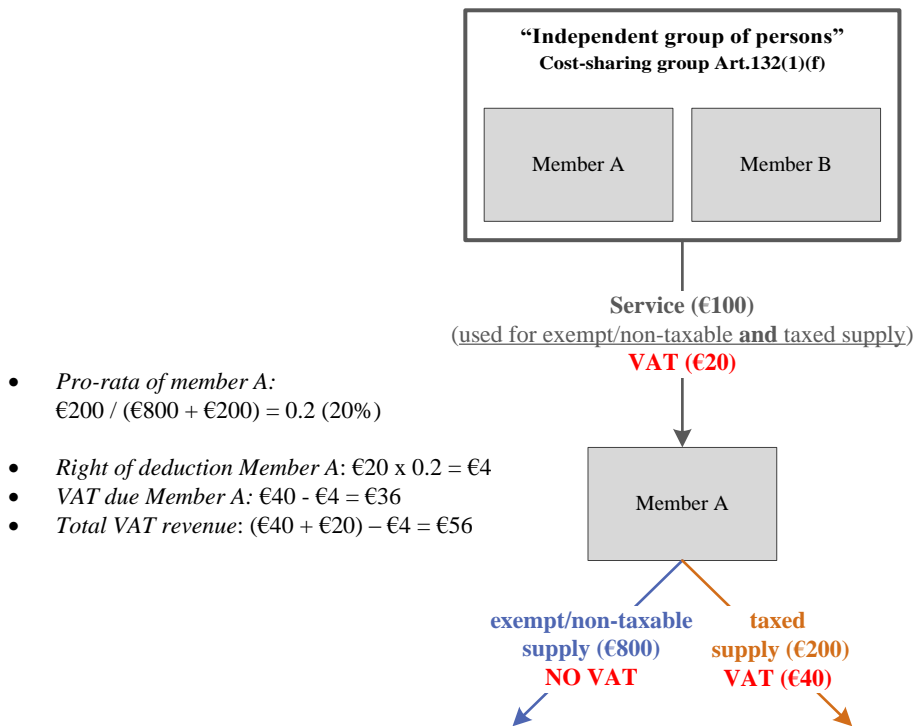
<sup>30</sup> CJEU, judgment of 21 March 2013 in case C-197/12 *Commission v. France*, paragraph 31.

the thresholds adopted by the Member States could lead to cumbersome application in cross-border scenarios.

– *Option C: Non-application of the exemption*

A third option could be not to apply the exemption in those cases where the services provided by the cost-sharing group are used by the member both for exempt/non-taxable downstream activities and for taxed downstream activities.

In fact, the position of a cost-sharing group would in these circumstances be identical to that of a third party provider of taxed services.



*Considerations*

This option could be seen as too restrictive by unduly excluding mixed taxable persons from benefiting from the exemption. In other words, it could be that under this option a mixed taxable person would receive services that are taxed although the conditions for these being exempt under Article 132(1)(f) of the VAT Directive could be met.

A taxable person with mixed activities could obviously make use of the pro-rata for the right of deduction, *i.e.*, deduct the proportion of the input VAT attributable to transactions in respect of which VAT is deductible.

Another consequence of taxing services supplied by a cost-sharing group is that it would encompass output VAT for the group which would be able to deduct the input VAT due in respect of such taxed transactions pursuant to Article 168 of the VAT Directive.

**3.4. Condition 3: The services supplied by the group must be "directly necessary" for the exercise of the members' exempt or non-taxable downstream activities**

*3.4.1. How should the expression "directly necessary" be interpreted?*

As already indicated<sup>31</sup>, the expression "directly necessary" must be considered to refer to services which are specifically related to the downstream activity and which constitute an indispensable input for those activities being carried out.

This, of course, should be analysed on a case-by-case basis, in view of the factual elements of each case.

**3.5. Condition 4: The services supplied by the independent group must be rewarded at cost ("exact reimbursement") – the group must not make a profit**

*3.5.1. Can a cost-sharing group make profit out of taxed supplies made to members or non-members?*

There seems to be no obstacle derived from the present wording of Article 132(1)(f) of the VAT Directive for an independent group being able to supply services to third parties who are not members of the group, provided that those services (in so far as they are not covered by another exemption) are taxed<sup>32</sup>. On the other hand, it also seems possible for a cost-sharing group to supply taxed services to its members, where the conditions for the application of the exemption are not met.

It seems inevitable that a cost-sharing group could make a profit out of the taxed supplies made to members or non-members of the cost-sharing group. The condition that services supplied by the group must be at cost refers only to those services supplied to members in respect of which the exemption applies and the exemption cannot be put into question by profit generated from such other activities.

**II. Application of the exemption in cross-border scenarios**

**3.6. General remarks**

Some general remarks concerning the existence of a taxable supply and the place of supply rules, as well as an assessment of the conditions for the application of the exemption in cross-border scenarios – notably the distortion of competition test – were already made in our previous analysis<sup>33</sup>.

The purpose of this section is to provide some further analysis as regards the potential cross-border application of the exemption, as well as outlining the practical challenges which may arise in this respect. Specific scenarios are looked at in the following section.

*3.6.1. Should cross-border application of the exemption within the EU be possible?*

It should be noted that there is no basis in the wording of Article 132(1)(f) of the VAT Directive for limiting the exemption for cost-sharing arrangements to domestic

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<sup>31</sup> Working paper No 856 (section 3.3.1).

<sup>32</sup> Working paper No 856 (section 3.1.10).

<sup>33</sup> Working paper No 856 (section 3.6).

transactions, as repeatedly observed by the Commission services<sup>34</sup>. Therefore, the existence of a cost-sharing group, involving members located in more than one Member State, seems possible.

Although it is possible that the legislator might only have envisaged for cost-sharing arrangements to apply within the territory of a Member State in 1977, when the Sixth Directive<sup>35</sup> came into force, it seems clear that such an interpretation – which sees the exemption limited to domestic transactions only – would run counter to the objectives of the Single EU Market. Notably, it could hamper the possibility for smaller operators to link up with bodies in other Member States, creating cost-sharing groups which would enable them access to services on an economic basis where they can successfully compete with larger operators at EU level. With the place of supply of services having shifted to the Member State in which the taxable person receiving the services is established, this could also act as an obstacle to cross-border supplies.

*3.6.2. Could cross-border application of the exemption within the EU be excluded on the grounds of Article 131 of the VAT Directive?*

Some may be of the opinion that, due to the complexity of applying exemption in cross-border scenarios and despite the arguments favouring a broad territorial interpretation, the scope of the exemption should be limited to the domestic sphere and they would possibly argue that this could be done based on Article 131 of the VAT Directive.

Given what is said under section 3.2.4, it however seems unlikely that a limitation by which cross-border application is excluded could be justified on the grounds of that provision.

In this respect, note should be taken of the judgment in *Navicon*<sup>36</sup> where the CJEU was asked to determine whether the concept of "chartering", as used in Article 148(c) of the VAT Directive, applies only to the chartering of the whole vessel or also to the chartering of a part of it. This provision contains an exemption related to international transport and, more specifically, aimed at certain types of use of vessels. The tax authorities found that such concept had to be restricted only to the chartering of the entire capacity of a vessel, arguing that this interpretation aimed at facilitating the application of VAT in cases of deliveries outside the EU. In contrast, the CJEU concluded that "*while the words used to describe the exemption (...) must be strictly interpreted, to maintain a particular strict interpretation of the concept of chartering would lead to misconstruing both the wording and the objective of that provision*"<sup>37</sup>.

*3.6.3. Should cross-border application of the exemption outside the EU be possible?*

Although from the literal wording of the provision it cannot be discarded that a cost-sharing group may extend to a non-EU country, it is certainly so that a world-wide

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<sup>34</sup> Working paper No 856 (section 3.6); Working paper No 654 (section 3.1); and Working paper No 450 (section 2).

<sup>35</sup> Sixth Council Directive 77/388/EEC of 17 May 1977, on the harmonization 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).

<sup>36</sup> CJEU, judgment of 18 October 2007 in case C-97/06 *Navicon*.

<sup>37</sup> *Navicon*, paragraph 32.

application of the exemption would present major challenges<sup>38</sup>, compared to those posed by cross-border application of the exemption within the EU.

Control of the conditions laid down in Article 132(1)(f) of the VAT Directive by the competent tax authority is likely to become unmanageable, not only concerning the complex "distortion of competition" test<sup>39</sup>, but also as regards the other requirements whose assessment depends on very specific information obtained from countries with which there may be no appropriate legal instrument relating to mutual assistance.

This could be seen as impeding the exemption being applied beyond the EU but it is an issue which would require further scrutiny before a final conclusion may be reached. Hence the question as to whether the exemption may also apply in cross-border scenarios involving non-EU countries has been left aside in the analysis below.

### **3.7. Cross-border scenarios**

#### *3.7.1. General considerations*

In order to identify the main practical challenges which could arise from cross-border application of the exemption within the EU, several scenarios shall be presented. First of all, some considerations must be taken into account:

- *Individual application of the exemption:* As set out in section 3.2.5, it would seem that an assessment of whether the conditions for exempting a service supplied by a cost-sharing group to one of its members are met must be done individually for each service.
- *Which legislation to apply:* Given that the application of the exemption diverges across the EU, it is particularly relevant to determine which legislation applies. It seems that the legislation to be applied is that of the country where the transaction takes place according to the place-of-supply rules<sup>40</sup>.
- *How to assess distortion of competition:* The application of this test may be a challenge in cross-border scenarios, a fact which is aggravated by the lack of a common understanding concerning this requirement.

On the last point, several possible interpretations were presented in our previous analysis<sup>41</sup>, one of which was that the assessment of whether or not the exemption causes distortion of competition should be carried out in the Member State where the recipient of the services is established, that is, the market where the potential competitors supplying the same services as those supplied by the cost-sharing group are established, and regardless of where the place of supply of the services is. This is an interpretation based on the economic reality of the transaction (what matters is the place where potential suppliers may provide the same services as those passed on by the cost-sharing group). It is nonetheless true that nowadays this approach may not reflect with accuracy the market

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<sup>38</sup> Working paper No 856 (section 3.7).

<sup>39</sup> Working paper No 856 (section 3.6.3.i) and the present document (section 3.7.1).

<sup>40</sup> Working paper No 856 (section 3.6.1).

<sup>41</sup> Working paper No 856 (section 3.6.3.i).

behaviour, having in mind the existence of an EU single market and the fact that competitors may operate at EU level.

So, we must again make reference to another potential approach as regards the interpretation of the "distortion of competition test", based on the analysis made by the CJEU in *Taksatorringen*<sup>42</sup> for the purposes of Article 132(1)(f) of the VAT Directive. That alternative approach could certainly be easier to manage as it implies that: "*if, independently of all questions of taxation or exemption, these groups are assured of retaining their members' customer base because they carry out their operations efficiently, it could not be suggested that it is the exemption from which they benefit that closes the market to independent operators*"<sup>43</sup>. In other words, as put forward by the Advocate General, distortion of competition should not be a problem where cost-sharing groups keep their customer base to their members, *i.e.*, where cost-sharing groups only supply exempt services to their members.

### 3.7.2. Possible scenarios

The main obstacle for cross-border cost-sharing groups within the EU is that some Member States make the exemption dependent upon fulfilment of conditions other than those strictly arising from the wording of Article 132(1)(f) of the VAT Directive, and that others have not even transposed this provision into national law. Potential scenarios could be constructed along the following legislative situations: (i) cost-sharing exemption available<sup>44</sup>; (ii) cost-sharing exemption available but subject to particular conditions<sup>45</sup>; and (iii) cost-sharing exemption not available. Possible scenarios, each combining the legislative situation for the Member State where the cost-sharing group is established, with that of the Member State where the member is established, are outlined below.

		<b>MS2</b> where the member of the cost-sharing group is established		
		Exemption available	Exemption with specific conditions	Exemption not available
<b>MS1</b> where the cost-sharing group is established	Exemption available	<i>Scenario 1</i>	<i>Scenario 4.2</i>	<i>Scenario 5.2</i>
	Exemption with specific conditions	<i>Scenario 4.1</i>	<i>Scenario 2</i>	<i>Scenario 6.2</i>
	Exemption not available	<i>Scenario 5.1</i>	<i>Scenario 6.1</i>	<i>Scenario 3</i>

It must be noted that scenario 1 would not encompass any clashes in the assessment of the conditions for exemption to apply. Neither are any clashes to be expected in scenario 3 for the mere reason that exemption is not available in any of the two Member States

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<sup>42</sup> CJEU, judgment of 20 November 2003 in case C-8/01 *Taksatorringen*, paragraph 59.

<sup>43</sup> *Taksatorringen*, opinion of Advocate General Mischo, point 131.

<sup>44</sup> This option envisages the application of the cost-sharing exemption without any particular conditions other than those strictly following from the wording of Article 132(1)(f) of the VAT Directive.

<sup>45</sup> Particular conditions applied by one Member State are likely to differ from conditions applied by other Member States.

involved<sup>46</sup>. Hence the spotlight has been put on the remaining scenarios (highlighted in red), where potential clashes in the assessment of the conditions may arise.

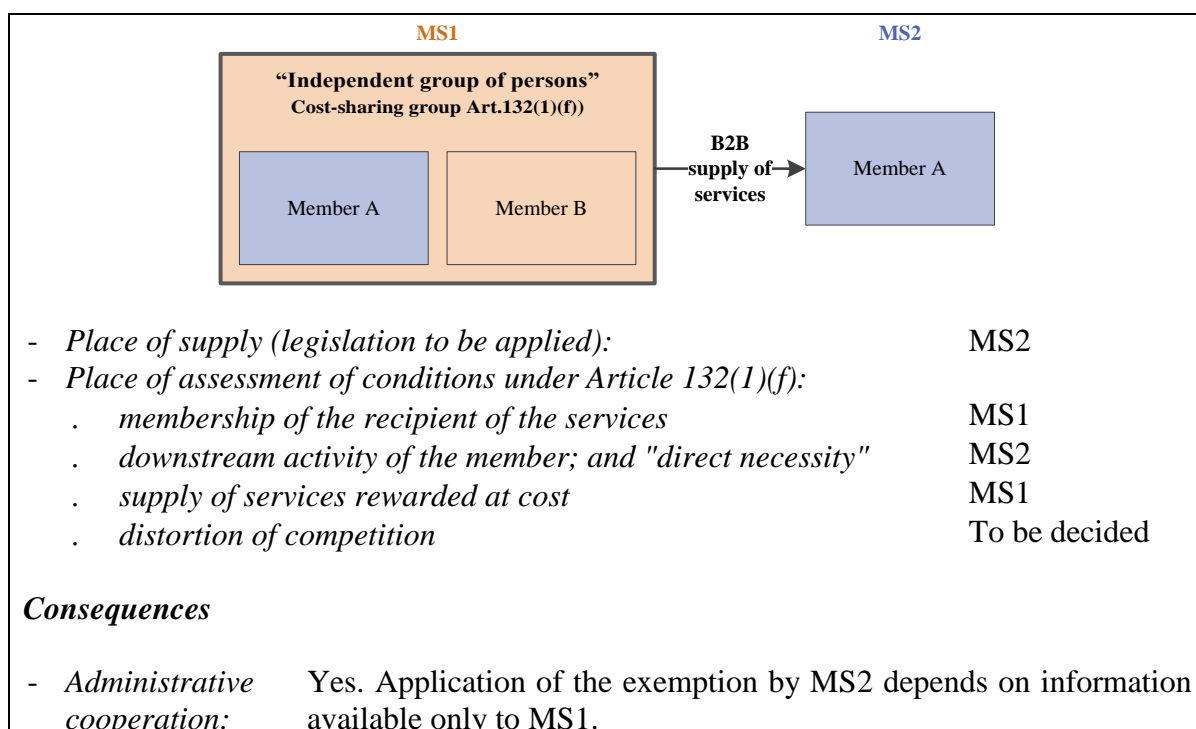
Given that for some of the scenarios the consequences may be similar, and for the sake of concision, the analysis is carried out based on a combination of the following outcomes<sup>47</sup>:

- the supply can be exempt according to MS1;
- the supply cannot be exempt according to MS1;
- the supply can be exempt according to MS2;
- the supply cannot be exempt according to MS2.

It must be kept in mind that situations in which the supply cannot be exempt may cover scenarios where the conditions for the exemption to apply are not met or where the exemption is simply not available. In the same way, situations in which the supply can be exempt may cover not only scenarios where the exemption is available, but also scenarios where the exemption is available subject to specific conditions.

Two types of transaction with an incidence on the place of supply – and, therefore, decisive as to which legislation to apply – shall be examined: business-to business (B2B) and business-to-consumer (B2C). It is assumed that the services supplied by the cost-sharing group to its members fall within the general rules of Articles 44 and 45 of the VAT Directive.

***Supply to a taxable person (B2B)***



<sup>46</sup> In this respect, the CJEU has declared that certain provisions of the VAT Directive may, under certain conditions, be directly applicable and relied upon by individuals, even where national legislation had not been adjusted in line with the Directive. See, inter alia, CJEU judgment of 19 January 1982 in case 8/81 *Becker*, in particular paragraph 34.

<sup>47</sup> Only the outcomes leading to a clash have been combined.

- *Clashes in the assessment of conditions:* Yes. It could be so that a supply of services meets the conditions for being exempt under the legislation of MS2 (the one to be applied), but not according to the legislation of MS1, or *vice versa*.

- *Tax revenue:* It is necessary to distinguish between the following:

*(i) MS1 not exempt + MS2 exempt*  
*[potential scenarios: 2; 4.1; 4.2; 5.1; and 6.1]*

If the supply of services meets the conditions for being exempt under the legislation of MS2 (the one to be applied), but not according to that of MS1, it seems apparent that MS1 could be obliged to accept that exemption is applied by the cost-sharing group in accordance with the legislation of MS2.

In normal circumstances, if the services had been taxed, reverse charge would have applied and the services provided to the company established in MS2 would have been invoiced with no VAT, and that company would have had to account for VAT in MS2.

Even if exemption is applied according to the legislation of MS2, the cost-sharing group could have a right of deduction pursuant to Article 169(a) of the VAT Directive<sup>48</sup>.

*(ii) MS1 exempt + MS2 not exempt*  
*[potential scenarios: 2; 4.1; 4.2; 5.2; and 6.2]*

If the supply of services meets the conditions for being exempt under the legislation of MS1, but not according to that of MS2 (the one to be applied), the member could not receive exempt services despite complying with all the conditions. Therefore, the services would be taxed, and it is likely that the member would not have right of deduction in respect of such input VAT pursuant to Article 168 of the VAT Directive (assuming that the downstream activities of that member are exempt or non-taxable).

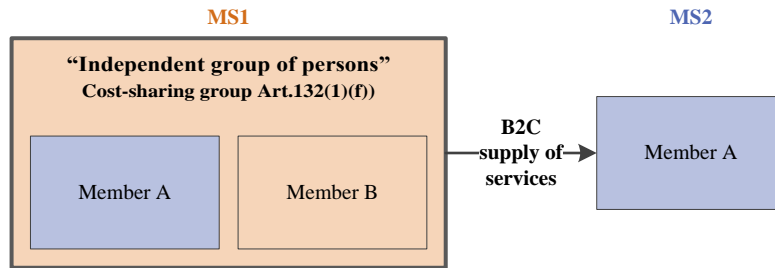
- *Grounds for abuse:* Yes. In case (i) analysed above, the cost-sharing group established in MS1 would enjoy a competitive advantage over businesses in MS2 supplying similar services, as in essence it will provide an exempt service whilst benefiting from a right to deduct input tax.

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<sup>48</sup> For more on certain aspects concerning right of deduction, see Working paper No 841, analysing the CJEU judgment of 12 September 2013 in case C-388/11 *Le Crédit Lyonnais*.



**Supply to a non-taxable person (B2C)**



- *Place of supply (legislation to be applied):* MS1
- *Place of assessment of conditions under Article 132(1)(f):*
  - . *membership of the recipient of the services* MS1
  - . *downstream activity of members; and "direct necessity"* MS2
  - . *supply of services rewarded at cost* MS1
  - . *distortion of competition* To be decided

**Consequences**

- *Administrative cooperation:* Yes. Application of the exemption by MS1 depends on information available only to MS2.
- *Clashes in the assessment of conditions:* Yes. It could be so that a supply of services meets the conditions for being exempt under the legislation of MS1 (the one to be applied), but not according to that of MS2, or *vice versa*.
- *Tax revenue:* It is necessary to distinguish between the following:

(i) MS1 exempt + MS2 not exempt  
**[potential scenarios: 2; 4.1; 4.2; 5.2; and 6.2]**

If the supply of services meets the conditions for being exempt under the legislation of MS1 (the one to be applied), but not according to that of MS2, it seems that MS2 would be obliged to accept the application of the exemption by the cost-sharing group according to the legislation of MS1. Had exemption not been applied, given that the place of supply is MS1, the impact for MS2 would still have been the same: no VAT payable in MS2 and no right of deduction for the member (B2C).

(ii) MS1 not exempt + MS2 exempt  
**[potential scenarios: 2; 4.1; 4.2; 5.1 and 6.1]**

If the supply of services meets the conditions for being exempt under the legislation of MS2, but not according to that of MS1 (the one to be applied), the cost-sharing group would not be able to exempt its services. Therefore, the services would be taxed, and given its status the member would not be able to claim refund of such input VAT from MS1.

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|-----------------------------|--|
| - <i>Grounds for abuse:</i> | Yes. For example, in case (i) analysed above, where a person established in MS2 and the cost-sharing group to which it belongs – also established in MS2 – would not meet the conditions for services to be exempted, that person could instead set up a cost-sharing group in MS1 (where, due to the particular conditions of the legislation, the exemption could be available). |
|-----------------------------|--|

### 3.7.3. Conclusions

From the scenarios presented above, several conclusions can be drawn.

First of all, administrative cooperation between national tax administrations in respect of supplies made by cross-border cost-sharing groups is essential. In all the scenarios envisaged, the assessment of the conditions laid down in Article 132(1)(f) of the VAT Directive must be carried out by one Member State but in some respect based on fact patterns in another Member State. This is because some conditions are closely linked to the cost-sharing group (*e.g.*, the supply of services must be rewarded at cost, for which the costs assumed by the cost-sharing group need to be examined), whilst others refer to the characteristics of the member of the cost-sharing group (*e.g.*, the downstream activities that the member must carry on). This aspect should largely be covered by way of administration cooperation<sup>49</sup> but additional notification requirements could be needed.

Secondly, concerning the assessment of the condition that the exemption of the cost-sharing group must not cause distortion of competition, several approaches could be taken, as previously described<sup>50</sup>. If distortion of competition is to be assessed in the Member State where the recipient of the services is established, it could be so that the Member State having to apply the test would not be the Member State where the recipient of the services is established, which could lead to a burdensome application of the exemption. Besides, due to the existence of the EU single market, it could be wondered whether an assessment of competition at EU level would necessary. This is however subject to agreement on how to apply the test, and another view<sup>51</sup> could be to consider that the market would not be closed to independent operators by a cost-sharing group keeping its members' customer base, and supplying services on an "exact reimbursement" basis. Applying the distortion of competition test in accordance with this latter interpretation would certainly ease the cross-border application of the exemption.

Thirdly, as regards potential clashes in the cross-border application of the exemption, the Commission services would like to stress that most, if not all of such collisions appear to be the result of Member States either (i) having introduced particular conditions which do not strictly stem from the wording of Article 132(1)(f) of the VAT Directive, and which are therefore not shared with other Member States; or (ii) the non-transposition of that provision. Hence a more uniform application of the exemption for cost-sharing

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<sup>49</sup> Council Regulation (EU) No 904/2010 of 7 October 2010 on administrative cooperation and combating fraud in the field of value added tax (OJ L 268, 12.10.2010, p. 1).

<sup>50</sup> See section 3.7.1.

<sup>51</sup> In this respect, see Working paper No 856 (section 3.6.3.i).

arrangements across Member States, including a harmonised approach as to the assessment of the tests to be applied, would seem the only way forward.

Finally, as regards the potential for abuse, it must be stressed that such risks do not stem from the cost-sharing exemption itself, as contained in the VAT Directive, but are nothing else than the result of the tax loopholes created by differences in interpretation and implementation of the exemption across the EU.

### **III. Interaction of the exemption with VAT groups**

#### **3.8. VAT group as a member of a cost-sharing group**

Article 11 of the VAT Directive contains a provision allowing Member States to introduce VAT grouping, whereby several persons are regarded as a single taxable person for VAT purposes. Those persons need to be established in the territory of the Member State making use of this option, and must be closely bound to one another by financial, economic and organisational links.

As already indicated<sup>52</sup>, the Commission services consider that there is no obstacle for a VAT group to be included in a cost-sharing group set up for the purposes of Article 132(l)(f) of the VAT Directive, provided that the conditions for the exemption to apply are met.

*3.8.1. Do all the entities of a VAT group need to be members of the cost-sharing group in order for the VAT group itself to be considered a member of the cost-sharing group?*

This question stems from the twofold perspective which can be adopted when looking at VAT groups: (i) the legal perspective; and (ii) the VAT standpoint.

The VAT group as such is not a separate body, but a fiction created for VAT purposes that encompasses several persons who are legally independent. However, upon joining a VAT group the group member dissolves itself from any possible, simultaneously existing legal form and instead becomes part of a new separate taxable person for VAT purposes – namely, the VAT group<sup>53</sup>.

So, although the VAT group operates in practice through its members, for VAT purposes services are seen to be supplied to and provided by the VAT group. Hence some may wonder under which circumstances a VAT group can be considered to be a cost-sharing group member; and, in particular, whether all the persons making up a VAT group would need to be members of the cost-sharing group for the exemption to be available to the VAT group; or, alternatively, whether the presence of one of the persons making up the VAT group would suffice.

First of all, it must be stressed that according to Article 11 of the VAT Directive, the VAT group is the only existing taxable person for VAT purposes and that there is a single VAT identification number – that of the VAT group – that is shared by all the persons of the group.

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<sup>52</sup> Working paper No 856 (sections 3.9 and 3.10).

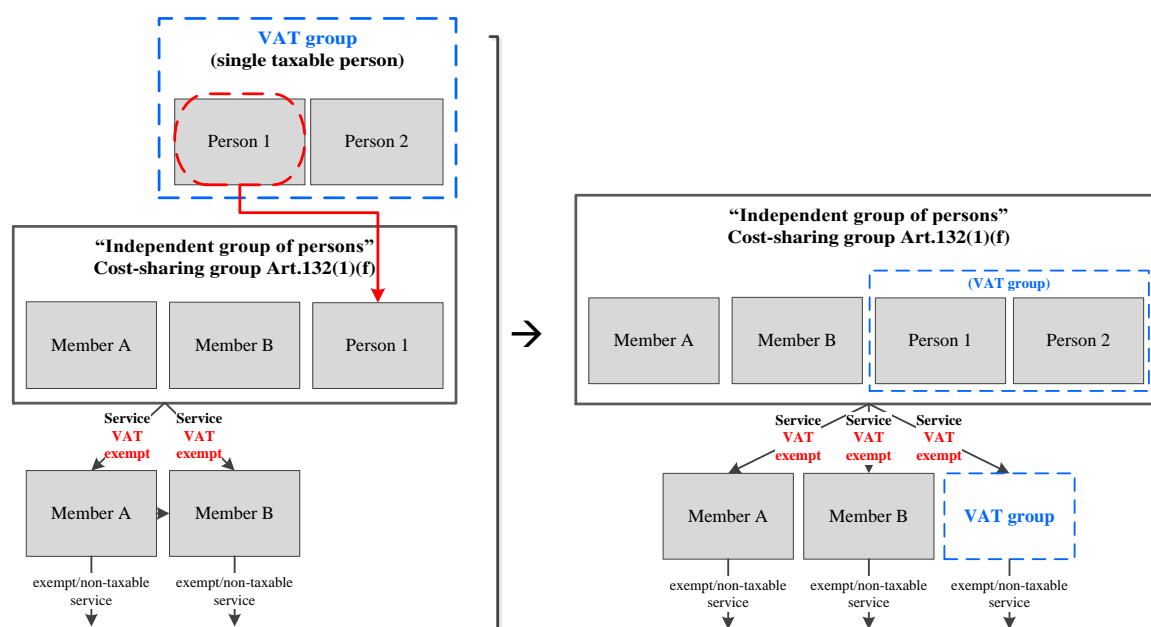
<sup>53</sup> See, among others CJEU, judgment of 22 May 2008 in case C-162/07 *Ampliscientifica*, paragraph 19.

Therefore, having in mind the essence of this instrument, if one of the several persons of a VAT group were, in their legal capacity, to become a member of a cost-sharing group, this quality (of being a "cost-sharing group member") should automatically extend to the whole VAT group for VAT purposes. In other words, for VAT purposes the VAT group as a whole should be considered to be member of the cost-sharing group, although in legal terms only one person of the VAT group had joined the cost-sharing group.

It is difficult to argue that services are being supplied by the cost-sharing group individually to a person forming part of the VAT group, since for VAT purposes the VAT group as a whole is the only existing taxable person.

If only one of the persons making up a VAT group under Article 11 of the VAT Directive is seen to be a member of a cost-sharing group and that membership would not include the whole VAT group, it does not seem possible, as previously said, that the exemption pursuant to Article 132(1)(f) of the VAT Directive could apply<sup>54</sup>. It could be so if a cost-sharing group would not extend membership to the other persons making up the VAT group who had not individually joined the cost-sharing group, thereby not treating the VAT group as a single taxable person for VAT purposes. As the supply made by the cost-sharing group is to a non-member (the VAT group), the conditions for applying the exemption would not, under such circumstances, be met.

However, as stated above, a VAT group must be treated in an overall manner. It seems to follow that where only one person of the VAT group joins a cost-sharing group, the whole VAT group should, for VAT purposes, be considered to be a member, as can be seen in the diagram below. Therefore, and subject to all the conditions of Article 132(1)(f) of the VAT Directive being met, the exemption could apply.



*Where only one person of the VAT group joins a cost-sharing group...*

*...the whole VAT group (single taxable person) should be considered to be a member of the cost-sharing group for VAT purposes.*

<sup>54</sup> Working paper No 856 (section 3.10).

*3.8.2. Do all the persons of a VAT group need to meet the conditions for the cost-sharing exemption being available?*

It has also been raised whether the conditions laid down in Article 132(1)(f) of the VAT Directive are to be met by each of the persons of the VAT group individually, or whether they can be assessed in an global manner.

In line with the approach presented in the previous section, and given that the VAT group constitutes a single taxable person for VAT purposes and that its members should not be looked at individually, it seems that the assessment of the conditions of the cost-sharing exemption should be carried out in an overall manner for the VAT group.

This is particularly relevant concerning the condition that the members of a cost-sharing group must carry on exempt or non-taxable activities. In this respect, if the VAT group as a whole, which is the only existing person for VAT purposes, carries on an activity which is exempt from VAT or in relation to which it is not a taxable person, the exemption should be available, provided that the other conditions are met. The fact that, from a practical point of view, these exempt or non-taxable activities may be carried on only by some of the persons making up the VAT group (and not every single person of the VAT group) is irrelevant and should be disregarded<sup>55</sup>.

In the same way, it seems that any person making up a VAT group could, in principle, receive exempt services from a cost-sharing group in practical terms since for VAT purposes the supply would be made by the cost-sharing group to the VAT group.

Besides, attention should be paid to the requirement that the services supplied by the cost-sharing group must be directly necessary for the exempt or non-taxable downstream activity in order for exemption to apply.

**3.9. Cost-sharing group as a member of a VAT group**

Provided that the conditions of Article 11 of the VAT Directive are met (the persons joining a VAT group must be established in the territory of the Member State where the VAT group is formed and are closely bound to one another by financial, economic and organisational links), there seems to be no reason for precluding a cost-sharing group from joining a VAT group.

It must be taken into account that upon joining a VAT group, the cost-sharing group would nonetheless become part of a new separate single taxable person for VAT purposes (the VAT group as a whole).

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<sup>55</sup> If some persons of the VAT group carry on exempt or non-taxable activities, and other persons of that same VAT group carry on taxed activities, the VAT group would qualify as a mixed taxable person, which in itself does not prevent the application of the exemption (see section 3.3.1 of the present document).

3.9.1. *Where a cost-sharing group becomes part of a VAT group, can that VAT group act as the cost-sharing group for the purposes of applying the exemption pursuant to Article 132(1)(f) of the VAT Directive?*

Where a cost-sharing group becomes part of a VAT group<sup>56</sup>, given the nature of VAT groups pursuant to Article 11 of the VAT Directive, it ceases to exist in terms of VAT and merges into a new single taxable person (the VAT group). In fact, that means that the cost-sharing group will no longer be able to operate under its original VAT identification number.

Whether the exemption could still apply under such circumstances depends on the requirements laid down in Article 132(1)(f) of the VAT Directive being met. In particular, as regards the condition that there must be a separate entity ("independent group") it seems that the individual members of the cost-sharing group would not automatically become part of a VAT group on account of the cost-sharing group's action. In other words, the fact that an entity acting as a cost-sharing group has become part of a new taxable person (the VAT group) does not necessarily mean that the members of that cost-sharing group also cease to exist individually and join that VAT group for VAT purposes. In this respect, joining a VAT group is dependent upon having financial, economic and organisational links pursuant to Article 11 of the VAT Directive.

Therefore, the VAT group could, as an entity independent from the members of the cost-sharing group, act as a (new) cost-sharing group in its stead.

On the other hand, Article 132(1)(f) of the VAT Directive requires, for the exemption to apply, that services are supplied by a cost-sharing group only to its members. This membership requisite seems to entail that the cost-sharing group "belongs" to its members<sup>57</sup>, and must be distinguished from being a "member" of the VAT group under Article 11 of the VAT Directive, as explained above.

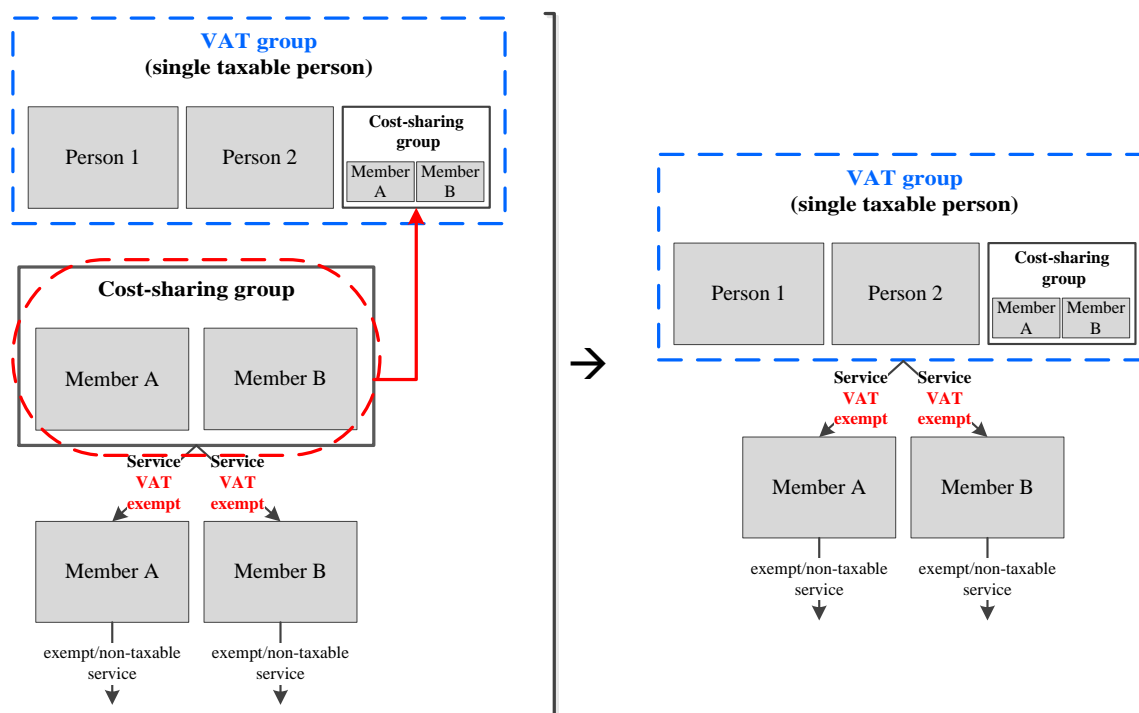
In the scenario at hand, it seems that the members could, through their membership in the former cost-sharing group, be seen as members of the new cost-sharing group for the purposes of applying Article 132(1)(f) of the VAT Directive.

Consequently, nothing seems to prevent the VAT group as a whole from acting as a cost-sharing group and taking over the role played by the original cost-sharing group which can no longer operate individually for VAT purposes. Subject to the rest of the requirements being met (which is dependent upon the characteristics of the activities of the individual members), it appears that the exemption could be applied under the circumstances described.

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<sup>56</sup> Assuming that the conditions laid down in Article 11 of the VAT Directive are met.

<sup>57</sup> Working paper No 856 (section 3.1.4).



Where a cost-sharing group joins a VAT group...

...the VAT group (*single taxable person*) could act as a (new) cost-sharing group in its stead.

As a result of previous discussions, it is to be noted that the position of the Commission services in this matter has evolved<sup>58</sup>.

#### IV. Final considerations

The provision which sets out the exemption for cost-sharing arrangements, contained in Article 132(1)(f) of the VAT Directive, has been interpreted and applied by Member States in diverse ways. Hence there is a need for clarification.

##### *Conditions for the cost-sharing exemption to apply*

In order for the exemption to apply, Article 132(1)(f) of the VAT Directive lays down five conditions to be met. The main findings concerning these conditions which have been assessed in the present document can be summarised as follows:

- It is necessary in order for the exemption to apply to have a separate entity acting as a cost-sharing group, but it does not stem from the wording of the provision or from the purpose of the exemption itself that the entity acting as cost-sharing group is required to have legal personality.
- It would seem difficult to argue that a person making up the entity used as a cost-sharing group is not a member of that cost-sharing group for VAT purposes.
- Although it seems that the vast majority of natural persons eligible for becoming members of a cost-sharing group would be self-employed, it seems that in some

<sup>58</sup> Working paper No 856 (section 3.11).

scenarios – related to voluntary work – natural persons who are not self-employed could also join a cost-sharing group.

- It seems possible for Member States, under certain circumstances, to restrict the scope of the exemption for cost-sharing arrangements by excluding non-taxable persons from joining a cost-sharing group, although measures taken pursuant to Article 131 of the VAT Directive must not affect the definition of the subject-matter of the exemption.
- It seems possible for a cost-sharing group to exempt services provided to its members, where such services are obtained from third parties and are supplied on to the members, given the fact that in any event those would be supplied in the name of the cost-sharing group and there would be no impact in terms of VAT revenue or the cost for the recipients of the services.
- There seems to be no basis in the wording of Article 132(1)(f) of the VAT Directive for restricting the exemption to cost-sharing groups whose members "exclusively" carry on exempt or non-taxable activities. Therefore, the exemption should be also available to mixed taxable persons. If the services exempted are only allocated to the exercise of exempt or non-taxable downstream activities by the member of the cost-sharing group no problem seems to arise. Where such exempt services are used for exempt or non-taxable as well as for taxed downstream activities, three different approaches as regards the application of Article 132(1)(f) of the VAT Directive are presented: (a) partial application of the exemption by means of the proportional right of deduction; (b) application of the exemption to the whole of the services, regardless of the fact that they may be used for taxed downstream activities; and (c) non-application of the exemption.
- Given that cost-sharing groups are allowed to supply services to third parties that are not members of the group, provided that those services (in so far as they are not covered by another exemption) are taxed, it seems inevitable that a cost-sharing group could make a profit out of these taxed activities. This should not in itself stand in the way of exemption of supplies made to members.

#### *Cross-border application*

Concerning the cross-border application of the exemption for cost-sharing arrangements, it should be noted from the outset that there is no basis in the wording of Article 132(1)(f) of the VAT Directive for the exemption to be limited to domestic transactions. Therefore, it seems that cross-border cost-sharing groups involving more than one Member State should be allowed, in line with the objectives of the Single EU Market.

Although from the literal wording of the provision it cannot be discarded that a cost-sharing group may extend to a non-EU country, it is certainly so that world-wide application of the exemption would present major challenges related to administrative control of the conditions laid down in Article 132(1)(f) of the VAT Directive. Although these aspects could be seen as hampering the application of the exemption beyond the EU, the Commission services believe that this issue requires further scrutiny before a final conclusion is reached.



In order to identify the main practical challenges which could arise from cross-border application of the exemption, it seems that: (i) the conditions under which a service is supplied by a cost-sharing group to one of its members must be individually assessed; (ii) the legislation to be applied should be that of the country where the transaction takes place according to the place-of-supply rules; and (iii) it is not clear yet how to assess the requirement that the cost-sharing exemption must not cause distortion of competition.

Several scenarios concerning the application of the exemption within the EU are presented. It follows that:

- Administrative cooperation between the tax administrations of the Member States concerned by a cross-border cost-sharing group is essential, given that the assessment of the conditions laid down in Article 132(1)(f) of the VAT Directive must be carried out in more than one Member State.
- Possible abusive scenarios have been identified, which would seem to be the result of Member States either (i) having introduced particular conditions which do not strictly stem from the wording of Article 132(1)(f) of the VAT Directive, and which are not shared with other Member States; or (ii) the non-transposition of Article 132(1)(f) of the VAT Directive. To deal with those issues, a harmonised approach as to the assessment of the relevant tests is imperative.

#### *Interaction of the exemption with VAT groups*

*A priori*, there seems to be no obstacle to the inclusion of a VAT group in a cost-sharing group or *vice versa*. However, since the way in which the exemption should be applied in such circumstances may not be straightforward, some specific scenarios have been analysed.

Where only one person of the VAT group joins a cost-sharing group, it seems that the whole VAT group should be considered to be a member of the cost-sharing group for VAT purposes. In line with this approach, and given that the VAT group constitutes a single taxable person, the assessment of the conditions pursuant to Article 132(1)(f) of the VAT Directive should be done in an overall manner for the VAT group.

On the other hand, where a cost-sharing group becomes part of a VAT group, it seems that, given the nature of VAT groups pursuant to Article 11 of the VAT Directive, the VAT group could act as a new cost-sharing group in its stead.

#### **4. DELEGATIONS' OPINION**

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

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