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VAT group: ECJ defines eligibility of partnerships as controlled companies

The ECI held that it is from the outset not compatible with EU-Law if the possibility for a partnership to form a VAT group - in addition to the controlling company – is limited to those partners in the partnership whose business is financially integrated into that of the parent. Such a restriction can only be justified by a specific need to prevent abuse.

Background

German law requires subordinate members of a VAT group to be subordinate, that is, that their business operation as well as their senior management be integrated into those of the parent. Also, only legal persons are admitted, and in the past partnerships were excluded altogether. This changed following the decision of the European Court of Justice (ECJ) in the **joint judgment of 16 July 2015** in the cases C-108/*14 Larentia* + *Minerva* and C-109/14 *Marenave*. Here, the ECJ held that German provisions excluding partnerships from VAT groups altogether and only admitting closely held subsidiaries are against the Sixth Directive and can only be justified by a specific need to prevent abuse.

Facts of the case

The Lower Tax Court of Berlin-Brandenburg referred questions to the ECJ for a preliminary ruling as to whether a restriction of the definition of "controlled company" in Section 2 (2) no. 2 sentence 1 of the German Value Added Tax Act (VAT Act) to legal entities and partnerships in which the partners, in addition to the controlling company, are only persons who are financially integrated into the company of the controlling company is compatible with the requirements of Article 11 of the Value Added Tax Directive (VAT Directive).

The decision of the ECJ is of noteworthy relevance insofar as the V. Senate of the Supreme Tax Court (judgment of 2 December 2015 - V R 25/13) has decided that partnerships also qualify as controlled companies if, in addition to the controlling company, their shareholders are only persons who are financially integrated into the company of the controlling company pursuant to Section 2 (2) no. 2 VAT Act. However, the XI Senate of the Supreme Tax Court, which is also responsible for VAT, has so far left open whether it intends to follow the aforementioned case law of the V Senate (cf. Supreme Tax Court, judgment of 1 June 2016 - XI R 17/11). According to the case law of the ECJ, partnerships may only be excluded from the tax group if this is necessary and appropriate to prevent abusive practices and to avoid tax evasion or avoidance.

In the case at hand, the tax office had denied the existence of a VAT group with reference to the case law of the V. Senate of the Supreme Tax Court.

Decision of the ECJ

The ECJ ruled that Article 11 of the VAT Directive precludes a national provision which makes the possibility for a partnership to form a VAT group together with the company of the controlling company dependent on the fact that, in addition to the controlling company, only persons who are financially integrated into this company are partners in the partnership.

Although Article 11 of the VAT Directive does not expressly provide for the possibility for Member States to impose further conditions on economic operators for the formation of a VAT group, they may, within the limits of their discretion, subject the application of the VAT grouping scheme to certain restrictions, but only in so far as those restrictions are consistent with the objectives of the Directive, which is aimed at preventing

abusive practices and tax evasion or avoidance, and provided that Union law and the principles of legal certainty, proportionality and fiscal neutrality are respected.

Abusive practices and tax evasion: The referring Lower Tax Court must finally examine whether the proposed exclusion of certain partnerships constitutes a necessary and appropriate measure for the objectives of preventing abusive practices and of preventing tax evasion or avoidance. However, according to the ECJ, this can only be the case if it is evident from a number of objective indications that the transactions in question are essentially intended to obtain a tax advantage. The risk of tax evasion within the meaning of Article 11(2) of the VAT Directive must therefore not be purely theoretical.

Principles of proportionality: A national rule systematically excluding all partnerships whose partners include natural persons from the benefits of the VAT group goes beyond what is necessary to achieve that objective.

The principle of fiscal neutrality is intended to ensure that the conditions of competition are not distorted and prohibits economic operators carrying out similar transactions from being treated differently when VAT is levied. In the present case, according to the findings of fact of the referring tax court, both groups of partnerships carried out the same transactions and were in competition with each other. In such a case, it would be contrary to the principle of fiscal neutrality if partnerships whose partners were not all financially integrated in the manner described were excluded from making use of the VAT grouping scheme.

Furthermore, it was clear from the submission of the Lower Tax Court that the plaintiff had exercised its will in the GmbH & Co. KG through resolutions passed by a majority, so that the existence of close ties through financial relations can be presumed. The mere fact that its shareholders could theoretically amend the partnership agreement by means of verbal agreements in such a way that resolutions had to be passed unanimously in the future was not sufficient to invalidate this presumption. In this respect, this result could also not be called into question by the **principle of legal certainty**.

Source:

The ECJ case reference is C-868/19 *Finanzamt für Körperschaften Berlin,* judgment of 15 April 2021.

Schlagwörter

VAT group, controlled company, financial integration, partnership