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Supreme Tax Court: Two follow-up decisions on VAT group requirements

In two current judgments the Supreme Tax Court has commented on the German VAT Group requirements following preliminary rulings which the court had referred to the ECJ in 2109 and 2020 and on which the ECJ provided answers in its judgments of December 2022. In one decision the Supreme Tax Court changed its case law on financial Integration. In the second case, the Supreme Tax Court saw the need for yet another preliminary ruling from the ECJ regarding the VAT situation of intra-group transactions.

Background

In two decisions the Supreme Tax has commented on the German requirements for a VAT group (*Organschaft*) following preliminary rulings which it submitted to the ECJ and on which the ECJ commented in the two judgments of 1 December 2022 in cases C-141/20 *Norddeutsche Gesellschaft für Diakonie* and C-269/20 *Finanzamt T* (more details to be found in our **blog post of 1 December 2022**). With one decision the Supreme Tax Court changed its case law on financial integration. In the second case, it made a new reference for a preliminary ruling to the ECJ regarding a further issue which was left open by the ECJ in its earlier judgment of December 2022**.**

Final judgment and change of case law

In its **ruling XI R 29/22 (XI R 16/18)** following the ECJ decision of 1 December 2022 *Norddeutsche Gesellschaft für Diakonie,* C-141/20, the Supreme Tax Court continues to regard the tax liability of the *Organschaft* parent for the transactions of the whole tax group as being in conformity with EU law, contrary to its earlier doubts. The conditions to be met according to the ECJ (for the parent to impose the will of its own on the controlled company and no risk of loss of tax revenue) are guaranteed, since in his jurisdiction the Supreme Tax Court already presupposes the possibility of enforcement of the will and that the controlled company is liable for the VAT of the controlling company pursuant to Section 73 of the German Fiscal Code.

Following the answers given by the ECJ the Supreme Tax Court now discards the requirement of a majority of voting rights as a precondition for financial integration and changes its case law previously held on this matter.

In its 2022 decision the ECJ had ruled that the VAT Directive precludes a national regulation which makes the possibility for an entity to form a VAT group with the controlling company subject to the condition that the controlling company holds a majority of the voting rights in addition to a majority holding in the share capital of that entity.

In consequence, the Supreme Tax Court states that, in principle, it is still necessary for the controlling company to hold the majority of the voting rights in the controlled company in order for a fiscal unity (*Organschaft*) to be tax effective. However, a financial integration now also exists if the shareholder holds only 50% of the voting rights but the required enforcement of his own will in the controlled company is ensured by the fact that he holds a majority interest in the capital of the controlled company and that he is the sole managing director of the controlled company.

Further request for preliminary ruling

The purpose the **second reference V R 20/22 (V R 40/19)** submitted by the Supreme Tax Court to the ECJ (following the ECJ decision in the case C-269/20 *Finanzamt T*) is to clarify whether the present practice that internal transactions between members of the VAT group are not VATable should be continued. This approach presupposes that the *Organschaft* subsidiary is a dependent part within the whole group of the controlling parent.

For the Supreme Tax Court, there are grounds for questioning this approach since the ECJ considers the controlled company to be independent and, according to its case law, the creation of a tax group must not lead to the risk of tax losses. But this is exactly what could happen if, as in the case in dispute, the controlling company which received services from the subsidiary is not entitled to full input VAT deduction.

From the ECJ judgment *Norddeutsche Gesellschaft für Diakonie* (specifically para. 77 through 80) it follows settled case-law that a supply of services is taxable only if there is a legal relationship between the service supplier and the recipient in which there is a reciprocal performance. It is therefore necessary to determine whether an independent economic activity is carried out. Namely if the company performs its activities in its own name, on its own behalf and under its own responsibility and in particular that it bears the economic risk arising from its business.

If, in its capacity as a single taxable person and representative of the VAT group, the controlling company is responsible for submitting the tax return on behalf of all the entities forming part of that group, the fact remains that those entities themselves bear the economic risks associated with carrying out their respective economic activities. It follows that those entities must be regarded as carrying out independent economic activities, with the result that they cannot be classified, by way of categorization, as ‘non-independent entities’ under governance of the Sixth Directive simply because they belong to a VAT group.

For the ECJ that interpretation is supported by the fact that, although it follows from the second subparagraph of Article 4(4) of the Sixth Directive that the entities which can constitute a VAT group must have close financial, economic and organizational links, this provision does not provide that the existence of such links would involve the exercise of a non-independent economic activity by an entity of the group other than the controlling company. Thus, it does not follow from that provision that that entity would cease to carry out independent economic activities solely because it belongs to the VAT group.

Should the ECJ in the pending referral rule that intra group sales and services are taxable, contrary to the established Supreme Tax Court case law, this would have far-reaching consequences. Under VAT law, the tax group serves as a structural mechanism for entrepreneurs who are not entitled to a full input VAT deduction (e.g., banks and insurance companies, entrepreneurs in the health and social services sector and in the education sector, as well as landlords of apartments). So far, non-deductible input VAT amounts can be legally avoided for such companies by establishing fiscal unities with service providers, so that the purchased services are not subject to VAT.

Source:

Supreme Tax Court, decision of 18 January 2023, case ref. XI R 29/22 (XI R 16/18

Supreme Tax Court, decision of 26 January 2023, case ref. V R 20/22 (V R 40/19)

The ECJ case reference is **C-141/20** *Norddeutsche Gesellschaft für Diakonie* and **C-269/20** *Finanzamt T* judgments of 1 December 2022.

Schlagwörter

VAT group, financial integration