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VAT group exclusion by legal entity only to prevent abuse

The ECJ has held that German provisions excluding partnerships from VAT groups altogether and only admitting closely held subsidiaries are in conflict with the Sixth Directive and can only be justified by a specific need to prevent abuse.

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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, so partnerships are excluded altogether. Two cases have been filed with the ECJ, both challenging both provisions. In both cases the admission of the input VAT on the costs of recruiting new shareholders was also in dispute.

The ECJ has joined the two cases and held, firstly, that the VAT deduction is justified if the expense was incurred in connection with an economic activity. An economic activity could be seen if the parent actively managed the subsidiary (and regularly supplied it with administrative, financial, commercial or technical services). If the parent met this criterion, its input tax was incurred on general business expenses and was deductible in full. Only if part of the subsidiaries' turnover was VAT-free could the relevant portion of the VAT expense be excluded from the deduction. Apportionment was to be on the VAT Directive basis of turnover split between taxable and tax-exempt business activities.

On the question of eligibility for VAT grouping, the ECJ held that the German restrictions excluding partnerships from group membership altogether and allowing only commercially and organisationally integrated subsidiary companies to join, exceeded in both cases the restrictions set by the Sixth (VAT) Directive. However, the directive's objects were simplification and the prevention of tax abuse. If, therefore, the national authorities could convince their own courts that the particular German circumstances required the more stringent German provisions, these latter would be justified in community law.

The ECJ case references are C-108/14 *Larentia + Minerva* and C-109/14 *Marenave* **joint judgment of July 16, 2015**.

Keywords

VAT group