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By PwC Deutschland | 27 January 2026

ECJ: No strict interpretation of tax exemption for municipal cost-sharing arrangements

Is the supply of services by independent groups of people to their members VAT free without distorting competition? The European Court of Justice has commented on this issue in a request for a preliminary ruling from Spain regarding VAT exemption for municipal cost-sharing schemes. The judgment also has implications for the corresponding German exemption in Section 4 No. 49 of the Value Added Tax Act (VAT Act).

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Key aspects of inter-municipal cooperations

Inter-municipal cooperation refers to voluntary, structured collaboration (partnership) between legally independent municipalities (cities, towns, counties) to perform tasks jointly. The objectives are cost savings, increase efficiency, pool skilled personnel, and improve the quality of services through synergy effects.

Background

In its judgment of 22 January 2026 on two joined cases, the ECJ commented on the requirements for VAT exemption in the area of cost-sharing groups. The relevant EU provision exempts services rendered by a group to its members if the group merely passes on the exact costs of those services to its members. However, the tax exemption is subject to the proviso that such exemption is not likely to cause distortion of competition.

This judgment also has an impact on the requirements for VAT exemption under Section 4 No. 29 VAT Act which is granted for „services provided by independent associations of persons resident in Germany, the members of which pursue non-commercial welfare activities, which are VAT exempt according to numbers 11b, 14 to 18, 20 to 25 or 27, vis-á-vis the members resident in Germany, provided that these services are **used for the direct purposes** of carrying out such activities and the association requests, from its members, only exact compensation of the respective part of the collective costs, provided that this VAT exemption does not lead to **distortion of competition**."

The tax exemption under Section 4 No. 29 is meant to transpose Article 132(1)(f) of the VAT Directive into national law which Germany implemented as of 1 January 2020.

The ECJ decision in brief

The ECJ held Article 132(1)(f) of the VAT Directive

(1) to preclude a national legislation under which the supply of services by an independent group of persons cannot be classified as 'directly necessary' services where those services are necessary for the activity which is exempt from value added tax carried on by those persons, but **are not exclusively linked to that activity** on account of their general nature, and

(2) to **preclude an interpretation of national legislation** under which there is, as a matter of principle, **a distortion of competition** or a risk of distortion of competition **where the services supplied** by an independent group of persons to its members may, on account of their general nature, be used for any taxable activity and **not exclusively for the exempt activity** which they carry on.

Takeaway from the ECJ decision

The ECJ has now rejected a restrictive interpretation on two key points: **First**, the requirement of immediacy must not be interpreted too narrowly. **Secondly**, the Court made it clear that distortion of competition must be proven in concrete terms. The mere possibility of distortion of competition or an abstract risk assessment is not sufficient to deny exemption. **In summary**, the current ECJ decision is likely to significantly expand

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the scope of tax exemption for cost-sharing communities under Section 4 No. 29 of the VAT Act.

The tax administration currently takes a different view: For numerous legal entities under public law, the decision offers considerable potential for restructuring as the tax authorities are so far interpreting the VAT exemption in Section 4 No.49 in a strict sense as outlined in their letter of opinion dated 19 July 2022:

“Other services provided by a group of persons to the respective member must be used directly by the member to carry out the beneficial purposes. Activities that **merely indirectly serve to carry out non-taxable or tax-exempt transactions** by the members or are obtained by the members for such purposes (e.g., general administrative services) are not covered by the exemption as they merely promote these activities. In view of the intention and purpose of the exemption to compensate for competitive disadvantages vis-à-vis market participants **only a restrictive interpretation** of the competition clause can be taken into consideration which counteracts abuse and does not restrict the application of Section 4 No. 29 VAT Act in a manner contrary to its purpose.

Those affected should review their existing structures in light of the ECJ decision. Depending on the circumstances of the case, they may be able to invoke EU law directly.

Source:

ECJ, judgment of 22 January 2026 in the joint cases **C-379/24 and C-380/24** *Agrupació de Neteja Sanitària, AIE* and *Educat Serveis Auxiliars SCCL*.

Keywords

VAT Exemption, municipality