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VAT Groups in European VAT: the Actual and Preferred Treatment

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Table of Abbreviations

art.	article
Commission	European Commission
EU (also: Union)	European Union
FE	fixed establishment
IR	Council Implementing Regulation (EU) No 282/2011 of 15 March 2011 laying down implementing measures for Directive 2006/112/EC on the common system of value added tax
MS	Member State
RVD (also: Recast or VAT Directive)	Recast Directive 2006/112/EC on the common system of value added tax
Second Directive	Second Council Directive 67/228/EEC of 11 April 1967 on the harmonisation of legislation of Member States concerning turnover taxes – Structure and procedures for application of the common system of value added tax
Sixth Directive	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
TFEU	the Treaty on the Functioning of the European Union
VAT	Value Added Tax

1. Introduction

In the world where 60% of cross-border trade in the European Union (EU) is internal¹ we live and trade linked by global connections and dependent on endless organisational networks. Hence, it becomes necessary to legally recognise and facilitate cooperation between different corporate actors. Within the sphere of VAT legally independent but cooperating companies are as a rule of thumb treated separately. However, for VAT purposes two levels interdependence have been recognised. The European legislator conceived of an exemption to deal with unassociated companies (independent groups of persons) by the way of art.132(1)(f) RVD and established a grouping mechanism for closely linked companies by the way of art.11 RVD. While those legislative attempts deserve due recognition it is important to critically assess their consistency with the doctrine, general system of VAT and practical implications with the view to make the system of VAT consistent and hence, efficient.

This thesis is concerned with closely linked companies and the way in which so called ‘VAT groups’ are treated for VAT purposes. The author reviews contemporary problems stemming from the actual treatment of art.11 RVD (*de lege lata*) and offers a preferred treatment (*de lege ferenda*) of VAT groups given the meaning of ‘person’ for VAT purposes and the logic of the VAT system.

1.1. Objectives, methods and disposition of this paper

This paper looks at the current treatment of VAT groups under art.11 and points out selected problems that emerge from the wording or application of the provision. It aims to catalogue the most burning issues (independently selected by the author) and analyze them to flag problematic areas and lay ground for the overhaul of the provision. Moreover, the author will examine the concept of a ‘person’ in the VAT directive and look at the system of VAT as a whole in search of the proper scope of VAT groups and will suggest proper treatment.

For this purpose, section 2 of this paper provides a brief overview of VAT groups while section 3 furnishes a non-exhaustive inventory of issues related to VAT groups stemming either from the wording of the art.11 itself or national transposition in the MS. Six main issues will be identified. Section 4 examines the wording of art.11, its legislative history, objectives and context (both in terms of legislative intent and textual context of Title III) with the view to determine who, how and under what conditions may belong to a VAT group. Next, section 5 applies the conclusions of section 4 to problems identified in section 3. It identifies which problems can be eradicated just by proper interpretation of the directive and which require further legislative action. It also acknowledges problems which will remain despite further legislation and lists them. Finally, section 6 offers a summary and a proposal for reform.

1.2. Delimitations

The author takes the liberty to select issues related to VAT groups and does not aim to comprehensively cover all the issues posed by the VAT group regulation.

¹ B. Terra and J. Kajus, 2011, *A Guide to the European VAT Directives. Introduction to European VAT. Vol 1.* Amsterdam/Hornbaek: IBFD, p. 98;

Moreover, the author does not try to establish whether VAT groups are the best mechanism to deal with associated or connected companies. She rather attempts to find the preferred, improved version of the present treatment.

2. VAT groups - overview

2.1. Place of VAT groups in the VAT system

Value Added Tax (VAT) is a tax on consumption expenditure levied on all stages of production of most goods and services. The burden of VAT is shifted to the ultimate consumer by the deduction system which ensures neutrality of VAT -- output VAT is chargeable after deduction of input VAT borne directly by the various cost components on each transaction. The system of European VAT is currently regulated by the Recast Directive (RVD) together with the Implementing Regulation (IR).

The Recast Directive contains a single, yet multilayered, facultative provision enabling the existence and registration of VAT groups in a Member State. Art.11 provides that any independent persons who are linked by economic, financial and organisational ties may be considered as a single taxable person for VAT purposes. Those persons however, must be confined to a single jurisdiction (territoriality criterium). Member States who decide to exercise this option must previously consult the VAT Committee and may adopt additional arrangements to prevent tax abuse related to VAT groups. Art.11 reads as follows:

“(1) After consulting the advisory committee on value added tax (hereafter, the "VAT Committee"), each Member State may regard as a single taxable person any persons established in the territory of that Member State who, while legally independent, are closely bound to one another by financial, economic and organisational links.

(2) A Member State exercising the option provided for in the first paragraph, may adopt any measures needed to prevent tax evasion or avoidance through the use of this provision.”

The concept of a VAT grouping can be traced back to the German *Organshaft* which embodies the idea that substance should prevail over legal form and that companies which are technically independent but practically related should be treated as one². However, the concept only formally materialized in the EU legislation through the Sixth Directive in 1978. The groups, introduced with the view to simplify the system and prevent abuse by artificially splitting the enterprise to benefit from the small enterprise scheme have since been subject to serious critique by the Commission which attempted to abolish them in 1995. In its' recent document, Commission's communication from 2011, Commission reiterates its' commitment to get rid of art.11³ on the ground that VAT groups create competition between MS and affect fiscal neutrality in the internal market. Despite Commission's resistance the trend has been to adopt VAT group provision⁴. The reason for this lies

² C. Amand, "VAT Grouping, FCE Bank and Force of Attraction - the Internal Market is Leaking", *International VAT Monitor*, July/August 2007, p. 238;

³ Communication from the Commission to the European Parliament, the Council and the European Economic and Social Committee on the future of VAT Towards a simpler, more robust and efficient VAT system tailored to the single market Brussels, 6.12.2011 COM(2011) 851 final, p.16;

⁴ Communication from the Commission to the Council and the European Parliament on the VAT group option provided for in Article 11 of Council Directive 2006/112/EC on the common system of value added tax Brussels, 2.7.2009 COM (2009) 325 final, p.2;

in vast advantages for taxpayers and hope that administrative simplicity will attract foreign investment.

2.2. Advantages and disadvantages of VAT groups

2.2.1. To the taxpayer

VAT groups give independent companies cash flow advantages only comparable to those of a single company and simplify VAT administration for the taxpayer. Transactions within a group of companies are VAT neutral (just as transactions between fully taxable persons B2B) which enables companies to provide goods and services internally without being engaged in the deduction procedure. A group can avoid delays both from the supplier's customer's and tax authority's end (in the event of excess input and refund). Also intra-group transactions do not have to be accounted for unless otherwise required (e.g. by the self-supply regulations). A single VAT registration number for the whole group as well as a single tax representative responsible for administrative obligations (head of the group) make administrative compliance easier for most members of the group who are at least partially relieved from the burden of dealing with the Tax Authority. Those 'legitimate' advantages are however also coupled with certain advantages which the legislator did not intend to confer on a taxpayer. Those relate to deduction. Under VAT grouping provision and in accordance with case law⁵ it is possible to include persons with no or partial right to deduct input VAT. This possibility enables to effectively partially deduct VAT on taxed supplies which are used to produce exempt supplies giving the taxpayer the advantage which he would have not received had the group not existed⁶. However, while some groups might benefit from 'enhanced' ability to deduct groups which wholly consist of taxable persons can suffer from only partial deduction of overhead VAT when supplies are acquired for the benefit of the whole group.

Disadvantages of group registration are rather minimal. It could be argued that the initial difficulty to transition from a number of separate taxable persons to one and related to it, the problem to adjust bookkeeping and adopt international accounting standards are problematic but this is true for all the organisational changes. Therefore, disadvantages are not unique to groups and hence, marginal.

2.2.2. To the revenue

VAT groups are a cause of decreased revenue collection. The transactions that would have been taxable now escape the net of VAT and the transactions that would have not enjoyed a deduction now get a partial deduction. Furthermore, even despite reduced administrative burden related to processing fewer returns and managing fewer files VAT groups complicate the system and open the doors for illicit tax avoidance. *Ergo*, since groups enhance the plasticity of the VAT system by providing additional outlets for tax structuring they enable the taxpayer to 'play' with the group registration as to obtain a tax advantage. Swinkles lists a fair few tax avoidance schemes exploiting art.11⁷. The possibility of abuse is however not a problem unique to VAT groups and art.11(2) contains an anti-avoidance measure which prevents the occurrence of abuse. There are also other

⁵ C-85/11 *Commission v Ireland*;

⁶ J. Swinkles, "The Phenomenon of VAT Groups under EU Law and Their VAT-Saving Aspects", *International VAT Monitor*, January/February 2010, p.39;

⁷ *Ibid.*, pp.39-40;

measures, such as ECJ case law in the *Halifax*⁸ case, which target avoidance. Therefore, it is not clear whether VAT groups are indeed a major cause of avoidance; this issue is to be resolved empirically.

However, a study shows that introduction of VAT groups results in long term benefits such as increased employment in the region and inflow of new investors⁹. VAT groups facilitate outsourcing which on the other hand enables to realize economies of scale and increase GDP of a country¹⁰.

2.3. Implementation of VAT groups across the Union

Implementation of art.11 varies widely on many levels¹¹. Some countries have not adopted the provision at all (Poland, Luxembourg) while those that did vary substantially in ways they did so. Some have made VAT groups mandatory (Netherlands, Austria) while others have kept them voluntary for the taxpayers to opt in (Czech Republic, Belgium). Others have limited VAT groups to certain sectors (Sweden) or certain types of taxable persons (for example, exempt persons¹²). The tests which MS use to interpret sufficient economic, financial and organizational ties for VAT grouping purposes¹³ vary from country to country despite guidance from the Commission¹⁴.

Moreover, the MS are divided in the way they adopted the judgement in *FCE Bank*¹⁵ which says that a branch and head office are one taxable person for VAT purposes and hence, VAT neutral for intra-transaction purposes. In the context of international VAT groups *FCE Bank* has been adopted wholly (UK, Netherlands), partially (Finland, Cyprus) or not at all (Slovakia, Hungary)¹⁶ in the MS which changes the way in which territoriality criterium in art.11 is interpreted (see section 5.1 for further discussion).

Divergent interpretation of art.11 is not in itself problematic. For example the fact that certain countries impose compulsory registration of VAT groups does fit within the discretion afforded by the art.11. MS can adopt measures which tackle tax avoidance and prevent distortion of competition and hence, MS are at liberty to impose additional limitations or requirements to that effect (as exemplified recently in the *Commission v Sweden*¹⁷ case where Sweden was allowed to limit VAT

⁸ C-255/02;

⁹ E. Matyszewska, "Grupa VAT ułatwi rozliczenia", *Gazeta Prawna*, 18.11.2011;

¹⁰ T. Rzepa and M. Wyganowski, "VAT Grouping and Cost-Sharing Agreements - The Polish Experience", *International VAT Monitor*, July/August 2012, p.252;

¹¹ K. Vyncke, "VAT Grouping in the European Union: Purposes and Limitations", *International VAT Monitor*, July/August 2007, p.255;

¹² *Ibid*, p.255;

¹³ I. Massin and K. Vyncke, "EC Communication on VAT Grouping: An Attempt to Harmonize or to Restrict the Use of Group Registration?", *International VAT Monitor*, November/December 2009, p.457;

¹⁴ Communication from the Commission to the Council and the European Parliament on the VAT group option provided for in Article 11 of Council Directive 2006/112/EC on the common system of value added tax Brussels, 2.7.2009 COM (2009) 325 final, p.8;

¹⁵ C-210/04;

¹⁶ L. Bijl *et al.* "EU VAT Grouping Provisions: Update", Issue 5, August 2012, p.34;

¹⁷ Case C-480/10;

registration to companies acting in financial and insurance sectors for, arguably, the reasons countering tax avoidance). Furthermore, MS are allowed to take steps on the issues which the provision is silent about, such as group registration, provided they are in line with the purpose of the provision. The problem however arises when countries use the provision in a discriminatory or selective manner or when the divergences in implementation between countries are too big to tolerate. Within the field of a harmonized tax such as VAT radical discrepancies are particularly unwelcome because they affect the internal market and disrupt competition. In the next section the author will address those discrepancies in implementation which pose particularly unwelcome problems together with those issues which flow from the explicit wording of art.11 itself.

3. Actual treatment of VAT groups - Inventory of problems

3.1. Territoriality and the (in)ability to form cross-border VAT groups

Art.11 provides that VAT groups can be formed by persons “established in the territory of that Member State”. This territorial restriction is controversial on many levels which can be summarized in the following points:

1) It is unclear what it means to be “established” for the purposes of art.11. The circumstances under which a person is established in a MS can be understood to the effect that “being established” refers to either: 1) resident taxable persons only, or 2) resident taxable persons and resident FEs of non-resident taxable persons, or 3) resident taxable persons and non-resident taxable persons having a resident FE.

This “territoriality criterium” yields itself to two plausible interpretations. Under literal interpretation establishment ought to be interpreted to the effect that only companies which are physically present in the territory of the MS which adopted VAT groups are established within the meaning of the provision. This reading of the provision is strongly preferred by the European Commission and means that VAT groups exclude secondary establishments of resident taxable persons but can include secondary establishments of non-resident persons. Consequently, territorial criterium restricts the exercise of freedom of establishment under art.49 TFEU. Some authors¹⁸ have argued that it can be however justified by the need to preserve cohesion of the tax system or by the application of the fiscal principle of territoriality but have also maintained that there is a slim chance that the restriction would pass the proportionality test. However, an alternative interpretation of “establishment” is possible. Interpretation in light of ECJ case law, in particular the judgement in *FCE Bank*, allows to relax the strict wording of art.11. In synthesis, as pointed out above, ECJ in *FCE Bank* held that a head office and an overseas branch should be treated as one taxable person for VAT purposes. This means that foreign secondary establishments of a persons established in a country which adopted VAT group regime must be subsumed under VAT group structure which the primary establishment participates in. Interpretation in light of *FCE Bank* allows to create cross-border VAT groups provided it is proven that an overseas establishment is indeed a fixed

¹⁸ A. van Doesum et al. “Internal Market and VAT: Intra-group Transactions of Branches, Subsidiaries and VAT Groups”, *EC Tax. Rev.* 2007/1, p.38-39; R. Zuidgeest, “Cross-Border VAT Grouping”, *International VAT Monitor*, January/February 2010, p.29;

establishment and that this FE is not a separate taxable person¹⁹. MS apply the judgement in respect to VAT groups differently and as a consequence engage in harmful tax competition which distorts the internal market and facilitates abusive practices. The issues connected to varying implementation of *FCE Bank* will be addressed later in this paper (see section 3.2).

2) Territorial restriction understood literally distorts tax neutrality because it puts multinational companies at a disadvantage in relation to companies which act within a single jurisdiction.

3) VAT groups become a tool of tax competition between MS. The idea behind is that the MS which adopted art.11 becomes more attractive for businesses than those which did not. Since the territorial restriction operates the MS can now tax the transactions which he could not tax before either because the company would have not migrated to the MS at all had the VAT groups not been available there or because he can now tax transactions which would have not been taxable before the groups was established on its territory (i.e. transactions between a domestic head office and a non-resident FE become taxable when the head office or the FE joins a VAT group in their respective country according to Commission's Recommendation²⁰). Moreover, varying implementation of the judgement of *FCE Bank* creates further opportunity for tax competition.

It is unlikely that ECJ will revise the criterium of territoriality and declare it to be an unjustified or justified yet disproportionate restriction on the freedom of establishment despite the fact that there are strong arguments to that end. The restriction is encoded in the VAT Directive itself and even though secondary Union legislation must respect the principle of subsidiarity and not be contrary to primary Union law there is compelling evidence that unless the Union legislator abolishes art.11 all together or gives it a significant overhaul the provision will stand as it is. Case law²¹ indicates that unless the restriction found in secondary legislation is "so significant and so obvious that it cannot be tolerated by the EU's legal order"²² it will not be taken down by the ECJ.

3.2. Implementation of *FCE Bank*

The judgement in *FCE Bank* threw a curveball to anyone engaged with VAT groups. Apart from the aforementioned issues regarding the definition of "establishment" for the purposes of art.11 the judgement provoked an unsettling proposition -- a proposition that art.11 establishes a special person or a special scheme in the form of VAT grouping for VAT purposes and if so, group registration modifies the relationship between a group and foreign FEs of members of the group. To find that a VAT group benefits from a special status is to reconcile the territorial restriction of art.11 and ECJ case law; it is a solution to a complex situation where EU legislator and ECJ are, as appears to the author, at odds. The author will briefly deal with this proposition in section 4 of this

¹⁹ The ECJ jurisprudence (e.g. *DFDS* case) regarding the concept of fixed establishment suggests that a branch can constitute a separate taxable person provided it has sufficient independence and bears economic risks on its own account. However, a branch constitutes a single taxable person with its head office unless the contrary conclusion is proven.

²⁰ Communication from the Commission to the Council and the European Parliament on the VAT group option provided for in Article 11 of Council Directive 2006/112/EC on the common system of value added tax Brussels, 2.7.2009 COM (2009) 325 final, p.8;

²¹ Case C-475/01, *Commission v. Greece (Ouzo)*, para. 19. See also Case C-137/92 P, *Commission v. BASF and Others*, para. 49; and Case C-245/92 P, *Chemie Linz v. Commission*, para. 94.;

²² C. Bjerregaard Eskildsen, "VAT Grouping versus Freedom of Establishment", *EC Tax Rev.* 2011-3, p.116;

paper but it is important to discuss its implications before we introduce further issues related to implementation of the ECJ judgement in *FCE Bank*.

The European Commission argues that art.11 modifies the relationship between a VAT group and foreign FEs of constituent members of the group²³. A group becomes a separate, special person whose transactions with foreign FEs become taxable transactions upon the registration of the group. Whether or not such a reading of the expression “single taxable person” in art.11 is legitimate and whether a VAT group is a special “person” for VAT purposes will be dealt with in section 4 of this paper but for now, let’s consider the consequences of such proposition.

If the registration of a VAT group changes the relationship between the constituent members of the group and their foreign establishments it is clear that foreign FEs cannot belong to a domestic group (graph 1). It is however doubtful that the same holds water when a foreign FE joins a foreign group (graph 2). In the latter scenario the group would dissociate a FE from its head office which would ‘lose’ all its life juices from a head office which defines its activities and manages it. After all, a FE is a concept which only came to existence to recognise or acknowledge the presence of a foreign taxable person on the territory of another MS²⁴ even though that a FE must display a sufficient degree of independence to use services for its own needs²⁵. A FE would therefore morph into a shell with no content or become an effective subsidiary by managing itself. Just as much as the situation in which a foreign FE is left to its own devices by the head office joining a VAT group can be equated to a child fleeing home upon maturation the situation in which a foreign FE joins a foreign VAT group therefore being cut off from its management can be equated to a kidnapping of a child. The former is acceptable and even expected, the latter is undesirable. Some MS, namely the Netherlands²⁶ and Czech Republic²⁷, have made arrangements in which they include a foreign head office in a domestic group structure when a domestic FE joins a VAT group. This arrangement might be linked with the fact that the Netherlands accepts the judgement in *FCE Bank* in full. However, common sense requires that VAT groups include a head office when a FE joins a group. The consequences of Commission’s argument that a group is a new taxable person which modifies the relationship between group members and their FEs abroad has the consequence of meddling with companies corporate structure in a non-neutral way which produces doubts over who is this new person formed of. It is therefore of pivotal importance to settle the question whether art.11 gives rise to a special scheme or a special person and if it does, in what way does this new scheme or person shape the relationship between a group and other actors.

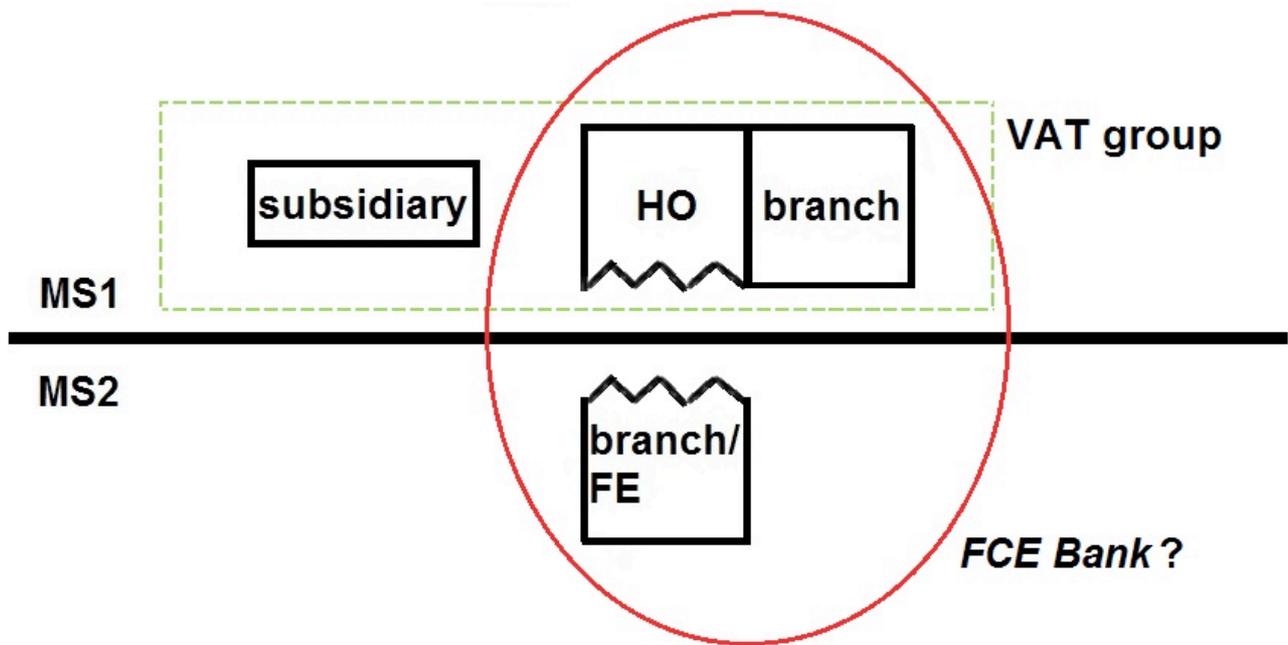
²³ Communication from the Commission to the Council and the European Parliament on the VAT group option provided for in Article 11 of Council Directive 2006/112/EC on the common system of value added tax Brussels, 2.7.2009 COM (2009) 325 final, p.8;

²⁴ H. van Arendouk, S. Jansen, R. van der Paardt (eds.), *VAT in an EU and International Perspective: Essays in honour of Han Kogels*, Amsterdam/Hornbaek: IBFD, p. 37;

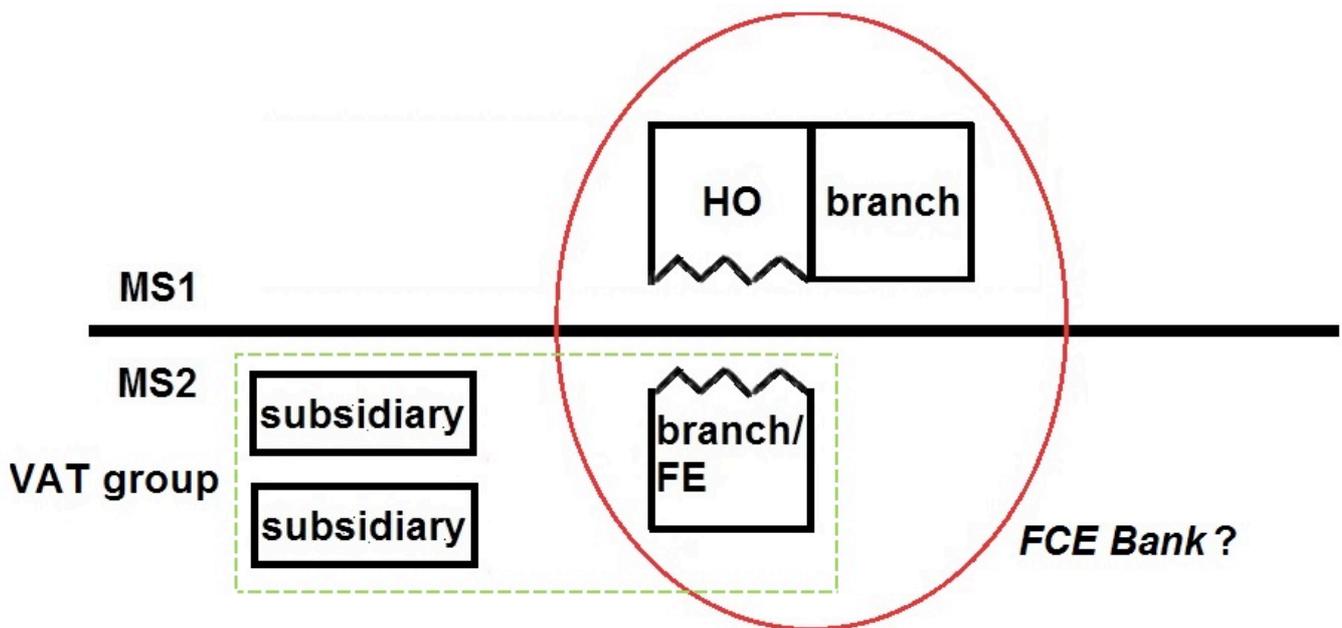
²⁵ Art.11 of the IR;

²⁶ Dutch Supreme Court, 12 June 2002, case No. 35976 (IVM 6 (2002), p. 538;

²⁷ L. Bijl *et al.* “EU VAT Grouping Provisions: Update”, Issue 5, August 2012, p.34;



Picture 1: Head office joins the VAT group - the relationship between the head office and foreign FE severed

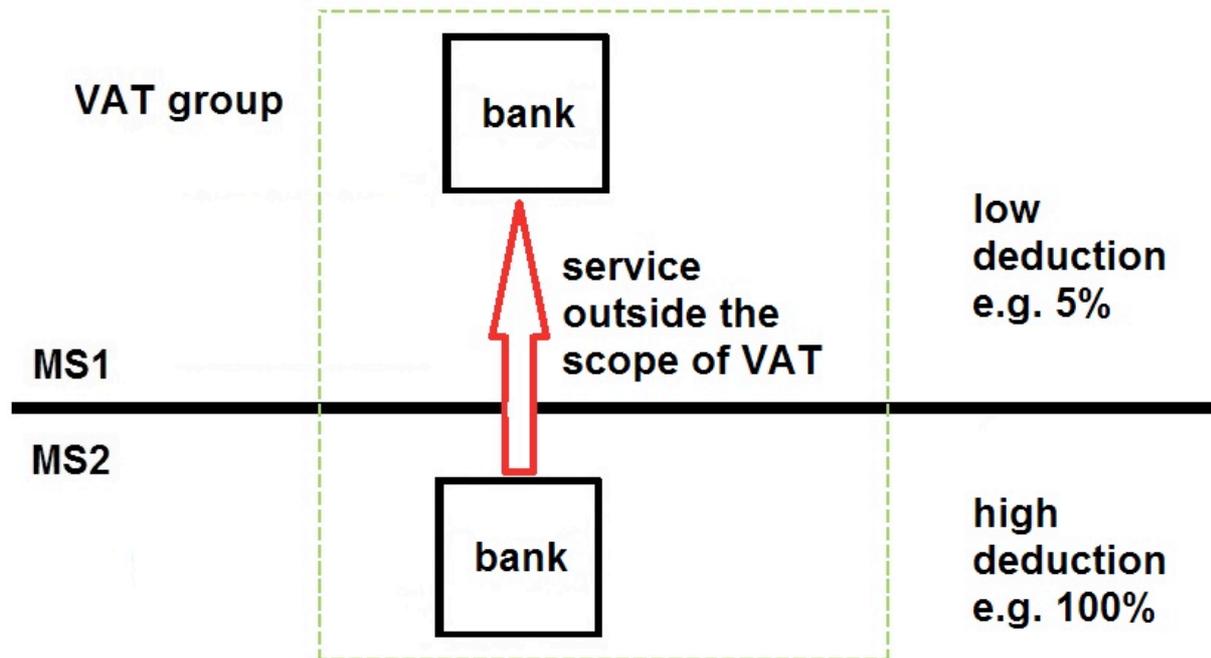


Picture 2: Foreign FE joins the VAT group - the relationship between head office and foreign FE severed

Some countries (UK, Netherlands) have fully embraced the judgement in *FCE Bank* and applied it to VAT groups. Although such MS certainly belong to minority the fact that Unionwide groups can be formed is a fact. As previously stated varying interpretation of *FCE Bank* distorts the internal market and causes tax competition. However, full application of *FCE Bank* can also lead to cases of double non-taxation, double taxation, potential abuse and problems with deduction.

Double non-taxation

When MS1 exercises VAT group option and fully applies *FCE Bank* while MS2 refrained from adopting VAT groups non-taxation might occur if a group is formed in MS1 and services are provided from MS2 to MS1. This situation has been illustrated on picture 3. In this situation²⁸, transactions between the group in MS1 and FE in MS2 would be outside the scope of VAT from MS1's perspective whilst a deduction would be possible in MS2²⁹. Alternatively, cross-border VAT groups might lead to double taxation³⁰. This remains a problem until MS decide to introduce internal taxation (deemed supply rule).



Picture 3: An example of non-taxation resulting from full implementation of the judgement in *FCE Bank*

Abuse

Moreover, implementation of *FCE Bank* opens up a possibility to structure one's business to avoid or abuse tax. Vyncke furnishes multiple examples as to how this might happen³¹. One of the scenarios involves a creation of a Unionwide VAT group which can for example benefit by setting up an FE and acquiring services from a country with a higher rate of deduction and channelling

²⁸ In this situation we assume the following: 1) services supplied between MS1 and MS2 are supplied at the place where customer is established, i.e. in MS1, 2) services are subject to reverse charge mechanism, 3) the services are not exempt.

²⁹ This example is taken from: R. Zuidgeest, "Cross-Border VAT Grouping", *International VAT Monitor*, January/February 2010, p.26;

³⁰ A. van Doesum et al. "Internal Market and VAT: Intra-group Transactions of Branches, Subsidiaries and VAT Groups", *EC Tax. Rev.* 2007/1, p.39;

³¹ K. Vyncke, "VAT Grouping in the European Union: Purposes and Limitations", *International VAT Monitor*, July/August 2007, p.258;

them to a country with a lower rate of deduction³². This strategy would be a successful and legitimate tax minimizing strategy for taxpayers providing e.g. banking services. It is however also possible to structure one's business so that it contains a head office which purchases VAT-free supplies outside the EU and streamlines them to an EU based FE. Some countries, like Belgium do not tax services rendered by a head office or a FE established outside the EU to its EU FE or head office³³. Such a scheme is currently being challenged in the ECJ in the *Skandia America Corporation*³⁴ case. It is unlikely that the Court will decide upon the question whether or not this use of Union law is abusive because the issue was not raised to the Court so it remains a mystery whether such use of *FCE Bank* in VAT group context is abusive or not. It however proves the point that liberal implementation of *FCE Bank* might be used to borderline or outright abusive ends.

Problems with deduction

Extension of VAT groups to include foreign FEs can result in problems with deduction of input VAT. It is due to differences in the kinds of activities MS decided to exempt, different methods used to attribute input VAT to taxable and exempt supplies, problems with mutual recognition of deduction caused by insufficient understanding of deduction system in another MS, lack of common definitions regarding for example capital supplies etc³⁵.

It remains to be seen whether the Commission will take steps to universalise the interpretation of *FCE Bank* and case's impact on VAT groups. In the past Commission has exerted political pressure on Germany to adopt its policy to align it with Commission's interpretation³⁶ so it is likely that Commission will at least attempt to harmonize this area. The process will be facilitated because in light of the Directive (confirmed in the *Ampliscientifica*³⁷ judgement) it is mandatory to consult the VAT Committee prior to the adoption of VAT group regulations and any substantive modifications thereto. As a consequence the process yields itself to scrutiny from and subsequent influence of the Union bodies on MS decision-making which results in approximation of laws. However, to universalise *FCE Bank* would mean to first understand the relationship between groups and their members and then, to consider the consequences of pan-EU VAT groups.

3.3. Voluntary nature

Art.11 is facultative and some MS have not exercised the option to permit group registration. Those that have had either instituted compulsory or voluntary registration process. The dissonance in implementation has both fiscal and constitutional consequences for MS. As previously mentioned, VAT group regime has been treated by the MS as a tool of harmful tax competition (see page 10). This flows exactly from regime's voluntary nature coupled with the requirement that VAT groups

³² R. Zuidgeest, "Cross-Border VAT Grouping", *International VAT Monitor*, January/February 2010, p.29;

³³ CFE Opinion on the Consequences of the ECJ Interpretation of the VAT Treatment of Transactions Between Head Offices and Branches (C-210/04, *FCE Bank*). Paper submitted by the Confederation Fiscale Europeenne to the European Institutions in 2008, *European Taxation*, January 2009, p.33;

³⁴ C-7/13;

³⁵ CFE Opinion on the Consequences of the ECJ Interpretation of the VAT Treatment of Transactions Between Head Offices and Branches (C-210/04, *FCE Bank*). Paper submitted by the Confederation Fiscale Europeenne to the European Institutions in 2008, *European Taxation*, January 2009, p.33;

³⁶ I. Massin and K. Vyncke, "EC Communication on VAT Grouping: An Attempt to Harmonize or to Restrict the Use of Group Registration?", *International VAT Monitor*, November/December 2009, p.460;

³⁷ C-162/07 *Ampliscientifica*;

must be confined to a single taxable jurisdiction. The distortion occurs at two levels, national and international. The distortion occurs at the national level when an opt-in system is in place and creates advantages to those who register. This distortion does not exist where the national system requires compulsory registration which treats all taxpayers equally. It is however problematic when both systems exist in the EU. This creates distortions on the international level.

In addition, the Commission has observed that “by design, many grouping schemes do not ensure that effects are limited to the national territory of the Member State concerned, which, according to the Commission, can run counter to the principle of tax neutrality and may be a source of tax competition between the Member States”³⁸. Rzepa and Wyganowski concur and argue that Poland is an example of a country where a VAT grouping provision is absent, yet, the taxpayers can benefit from its spill over effects³⁹. When one MS transposes an optional article and it has a direct spill-over effect in other MSs, especially those who actively reject the facultative provision we are faced with an infringement of sovereignty. Sovereignty on the other hand has been used by the Commission as an argument to justify the territorial restriction in art.11 and debunk *FCE Bank*. It argues that a voluntary mode requires a territorial restriction to respect national sovereignty of those MS who reject the idea of VAT groups⁴⁰. It is clear that the measures employed to prevent infringements of sovereignty (territoriality criterium) do not match the expected outcomes.

The lack of neutrality and infringements of national sovereignty expose the deficits in the design of art.11 both on the level of insufficiently clear wording which leaves room for MS to introduce compulsory or voluntary group registration regime and on the level of insufficiently effective measures to address the spill-over effects of art.11 on the MS which refused to adopt the provision.

3.4. Sectoral approach

Sweden and Finland have restricted VAT group registration to companies operating in financial and insurance sectors. This sectoral approach is motivated by the attempt to give relief persons who suffer from the burden of non-deductable VAT and prevent tax avoidance. In the recent case, *Commission v Sweden*⁴¹, despite an AG Jaaskinen’s opinion to the contrary⁴², the ECJ has upheld the limitation on the ground that Commission failed to show that limiting the scope of art.11 is a measure ill-founded to prevent abuse⁴³. It is though important to observe that the ECJ in principle condemned sectoral approach.

³⁸Zuidgeest, “Cross-Border VAT Grouping”, *International VAT Monitor*, January/February 2010, p.27-28;

³⁹ Rzepa and M. Wyganowski, “VAT Grouping and Cost-Sharing Agreements - The Polish Experience”, *International VAT Monitor*, July/August 2012, p.253;

⁴⁰ Communication from the Commission to the Council and the European Parliament on the VAT group option provided for in Article 11 of Council Directive 2006/112/EC on the common system of value added tax Brussels, 2.7.2009 COM (2009) 325 final, p.7;

⁴¹ C-480/10;

⁴² Opinion of Advocate General Jaaskinen delivered on 27 November 2012 Case C-480/10 *Commission v Kingdom of Sweden*;

⁴³ C-480/10, para. 39;

Sectoral approach is problematic because it might constitute forbidden state aid under art.107 TFEU and because it stands in direct opposition to the literal meaning of the art.11. Such approach results in distortion of neutrality of competition because it privileges exempt persons.

3.5. Connectivity

According to art.11 in order to create a VAT group “any persons” need to demonstrate that they are connected by economic, financial and organisational ties. The article does not elaborate on the meaning of the three so it comes as no surprise that MS have developed divergent strategies to assess what constitutes the aforementioned ties. The Commission has however developed a framework and spelled out a set of directions to fulfill the economic test from art.11:

- the financial links refer to a percentage participation in the capital or voting rights which must amount to 50% or over;
- the economic link is defined in terms of close cooperation which exists when, for example, the economic activities of members of the group are the same in nature, complementary or interdependent or when one member of the group carried out activities partially or wholly for the benefit of the other members;
- the organisational link refers to the shared management structure⁴⁴.

All the criteria must be fulfilled simultaneously for the entire time the group exists; when a member of the group ceases to fulfill any of them at any given time he must leave the group. Here, connectivity becomes tricky. Firstly, the criteria so laid out do not enable to create groups where the circumstances render one of the criteria absent or hardly existent. Zuidgeest argues that it should be possible to group companies according to the primary or main connective factor, that is, weak links in one respect can compensate for other links⁴⁵. This could redress the inherent flaw of current criteria which is the assumption that real control is exercised through the exercise of voting rights or on the basis of shareholding. It would however further deepen another, already mentioned, problem with connective criteria -- the lack of legal certainty associated with dissonance between national tests. Further relativisation of the economic link test disturbs fiscal neutrality because it enables the taxpayers on one side of the border to form a group which taxpayers in the same circumstances over the other side cannot form. Uniformisation of the criteria is especially pivotal in those MS which introduced a mandatory system since taxpayers must be able to organize their affairs in accordance with law. Hence, even though current guidelines do not fully capture all the cases in which groups might exist (cases in which real control exists but is not captured by the three criteria) they at least provide some legal certainty and minimise the discretion afforded by the wording of art.11.

Secondly, links can only be established directly and cannot be established via companies not involved in a group, for example foreign subsidiaries or foreign FEs of group members⁴⁶. The economic link test in this respect is inflexible and does not allow to truly realise the ‘substance over form’ maxim because companies which would have been considered connected in a domestic setting lose that connection when foreign actors are involved. Existence of the group is therefore, at

⁴⁴ Communication from the Commission to the Council and the European Parliament on the VAT group option provided for in Article 11 of Council Directive 2006/112/EC on the common system of value added tax Brussels, 2.7.2009 COM (2009) 325 final, p. 9;

⁴⁵ R. Zuidgeest, “Cross-Border VAT Grouping”, *International VAT Monitor*, January/February 2010, p.30;

⁴⁶ *Ibid.* p.30;

least theoretically, conditional upon the legal structure of the enterprises and the length of the chain they form.

To conclude, art.11 suffers from a vagueness of the condition that “any persons” must be bound by financial, economic and organisational links. This gave grist for the mills for the MS which developed their independent, yet similar, tests which undermine uniformity of interpretation of art. 11 and legal certainty, so much desired especially in those MS which introduced mandatory group registration. The economic test developed by the Commission is however far from perfect as it does not allow to fully capture the control or influence which companies might have on one another. It furthermore, neglects the possibility that companies might be indirectly connected and fosters the idea that groups can be only formed by directly connected actors.

4. The Meaning and Scope of a ‘Person’ in VAT Group Context

It is well settled case law that in determining the scope of a provision or to determine the meaning of the words of EU law it is necessary to take into account the wording, context and objectives of the provision⁴⁷. Moreover, it is important to compare different equally authentic language versions of same same provision⁴⁸ paying equal attention to all of them regardless of the number of people speaking the language⁴⁹. The author will now look at literal, contextual, historic and purposive interpretation of the words “any persons” in art.11 and then investigate the meaning and scope of ‘person’ in ECJ case law to determine the preferred meaning of the expression in the VAT law.

4.1. Literal interpretation

Art.11 reads:

“[...] each Member State may regard as a single taxable person *any persons* established in the territory of that Member State who, while legally independent, are closely bound to one another by financial, economic and organisational links.”

The wording of the provision uses the expression ‘any persons’ to describe actors eligible to join a VAT group. Those words have been to a large extent adopted uniformly across different language versions of the VAT Directive⁵⁰ and have a qualitative and quantitative bearing on the composition, size and expanse of actors involved in groups.

The words ‘any persons’ entail broad participation in VAT groups. ‘Any’ means unlimited, unrestricted, unqualified, unconditional, whichever. The wording imposes no further qualitative conditions that persons who wish to participate in a group need to fulfill any additional criterium other than being a mere person for VAT purposes. It does not explicitly require that persons are taxable, it makes no distinction between taxable and non-taxable persons. Different language versions of art.11 RVD do not require that persons are taxable; no language version uses ‘taxable

⁴⁷ C-174/08 *NCC Construction Danmark*, para. 23;

⁴⁸ C-283/81 *CILFIT*;

⁴⁹ C-296/95 *EMU Tabac*;

⁵⁰ For example Polish, Czech and Slovak use the word “osoby”, Spanish “a las personas”, French “les personnes”, Italian “le persone”, Danish “personer”, German “Personen”, Swedish “sadana personer”. Romanian goes further and uses “orine persoane” which translates into “every person”.

persons' instead of 'persons' to describe the prerequisite for group registration. To the contrary, there is one language version, Romanian which uses the words "orine persoane" which translates into "every person" and shows that the definition of a "person" was to be as wide as possible. Moreover, the wording does not look at the status of the taxpayer, does not consider the right to deduct. 'Any persons' are also not confined to a sector, persons might come from all industries. Furthermore, the words 'any persons' imply that a person who belongs to one VAT group is free to join another VAT group provided the territorial restriction is respected and connective factors between persons found. Further wording of the provision does nothing to qualify this possibility. Literal interpretation of 'any persons' leads to conclude that VAT group can be registered when persons are taxable or non-taxable, with a full or partial right to deduct, come from one sector or another and belong to one or multiple groups.

'Any' in the expression 'any persons' does not impact the size of the group. Even though 'any' could be interpreted to the effect that taxpayers can admit unlimited number of actors into the group -- any many persons -- the word 'any' does not have a quantitative dimension. 'Any' describes the quality of taxpayers. It is however a valid concern that the provision does not specify the maximum size of the group and leaves it open to MS to determine the issue. Laissez faire approach to the issue of size of groups combined with other factors such as mandatory registration results in registration of groups which are too big to handle which vitiates the objective of VAT groups which is widely understood simplification.

However, apart from the wording due regard should be paid to grammatical context when interpreting the meaning of any provision of EU law. Looking at the grammatical context requires inquiring into how the interpreted word fits into the structure of the provision. In art.11 the word 'person' appears twice, once to describe the prerequisite for group formation ('any persons') and once to describe the consequence of group registration ('single taxable person'). Despite the fact that the expression 'single taxable person' appears prior to 'any persons' it does not mean that the legislator intended to import the word 'taxable' from 'single taxable person' into 'any persons'. Had the legislator wished members of the group to be taxable persons he would have stated so explicitly. The fact that 'any persons' can form a 'single taxable person' does not imply that they must be taxable persons to form a 'single taxable person'. The conclusion might have been different had the legislator failed to put the word 'any' before 'persons'. Then, the characteristics of a person would have been in doubt given the lack of proper grammatical treatment. However, currently, despite its wide characteristics, a 'person' is sufficiently well defined for the purposes of art.11.

The omission to put the word 'taxable' in the expression 'any persons' cannot be motivated by the intention to avoid repetition either as the Commission argued in *Commission vs. Ireland*⁵¹. Contrary conclusion is appropriate. When the EU legislator uses the word 'persons' instead of 'taxable persons' to avoid repetition this happens outside Title III. Moreover, it is clear from the reading of Title III that when the EU legislator wants to include a 'person' in the scope of 'taxable persons' he does so explicitly. Such a stylistic intervention is visible in art.9(2) where 'persons' who carry out activities on occasional basis shall be regarded as taxable persons. The fact that the words 'taxable person' appears earlier in the text is caused by the grammatical construction, not by the intention to carry the word 'taxable' over, nor by the desire to avoid repetition.

⁵¹ C-85/11;

4.2. Contextual interpretation

4.2.1. Immediate context

Art.11 can be found in Title III RVD ('Taxable persons') which contains general and specific provisions regarding taxable persons in art.9-13. Art.9 is a general provision defining the concept of a taxable person while the subsequent provisions in Title III expand on this definition by including (work on occasional basis) or excluding (public authorities) categories of persons from the definition of a taxable person. Art.11 ought to be understood mainly in the context of Title III but regard should be also had to any provisions in the VAT Directive that help to navigate the meaning of the provision in question.

Art.11 uses terms defined in art.9 and builds on it. However, this is not to say that to be eligible to benefit from perks of art.11 a taxpayer must fulfill the criteria laid down in art.9. It also does not mean that to use art.11 one must be specifically excluded from the scope of art.9. The two articles are distinct and neither of the articles makes explicit references to the other. This would mean that the expression "any persons" is a self-standing expression, making no references to art.9. That is, "any persons" do not have to be taxable persons because art.9 pertains to taxable persons. The fact that art.9 defines taxable persons does not mean that subsequent provisions use 'taxable persons' unless otherwise proscribed. In fact Terra and Kajus make an argument that the construction of art.9 points to the conclusion that unless a "person" is caught within the net of art.9 i.e. is any person who independently carries out in any place any economic activity whatever the purpose or result of that activity, it remains a non-taxable person⁵². However, it could be argued that art.9 and art.11 read in conjunction form a logical whole and that interpretation of art.11 should not affect interpretation of art.9 which could occur if "any persons" was not interpreted as "taxable persons"⁵³. This could potentially undermine art.9. Nevertheless, it is important to note that art.9 is not *lex superior* to art.11 which means that when art.9 does not take priority when in conflict with art.11. Those two articles form a logical whole within the Title by building on and not complementing each other. The same can be said about the relationship between art.9 and any other article in Title III. Therefore, art.11 does not undermine art.9.

If art.9 was unable to help us further refine the meaning of "any persons" in art.11 the same holds for the expression "persons established in the territory of the MS". Art.9 does not use the concept of establishment to define a taxable person which would be helpful to explain what it means to be established for a "person" in the meaning of art.11. However, a less immediate context can shed some light on the issue. Art.44 and the place of supply rules inform us about what a "person" is composed of. The article acknowledges that a "person" can have multiple establishments, both primary and secondary, which nevertheless constitute one person and which facilitate determination of place of supply of services. Art.44 stretches geographically all "persons" in Title III, also "any persons established in the territory of the MS". If a "person" is established in a MS it means that its primary establishment is situated there. All the secondary establishments may be registered abroad and perform a function for the place of supply purposes but they are intrinsically linked with the primary establishment. The "person" in the VAT directive transcends boundaries, a "person" is not

⁵² B. Terra and J. Kajus, 2011, *A Guide to the European VAT Directives. Introduction to European VAT. Vol 1.* Amsterdam/Hornbaek: IBFD, p.359;

⁵³ As argued by the Commission in C-85/11 *Commission v Ireland*, para. 28;

defined by its scope and establishment denotes a function rather than geographical affiliation for VAT purposes.

The reading of art.11 in light of its context in the directive tells us something about the concept of a “person”. A “person” is not geographically limited, the fact that it is functionally divided does not change this conclusion. The expression “any persons” should not be understood as “taxable persons”. In fact, the literal meaning of the expression remains unaffected by other provisions in Title III because they are not immediately linked but merely grouped by the theme. Art.9 sets the tone for the subsequent provisions but does not impact the way that “any persons” should be interpreted for the purposes of art.11.

4.2.2. The VAT grouping option in the broader VAT regime context - neutrality

According to the principle of conferral secondary EU legislation must stand in conformity with the primary Union legislation. Union bodies can legislate only within the remit of the competences conferred on them by the treaties and respect the common values, principles and objectives encapsulated therein⁵⁴. The ECJ which investigated the relationship between primary Union law and VAT in the *Schmelz*⁵⁵ case affirmed that the system of VAT must be compatible with Treaties, especially with the fundamental Treaty freedoms. Hence, the system of VAT must respect the fundamental freedoms, the principle of equal treatment, the principle of non-discrimination. It is settled case law that the principle of equal treatment are reflected in the principle of fiscal neutrality⁵⁶.

Interpretation of terminology should be guided by the legal character of the tax⁵⁷. VAT is a general tax on consumption expenditure, levied on all stages of production. The principle of neutrality is reflected in VAT’s generality and deduction system structure⁵⁸. VAT achieves neutrality of legal form and neutrality of competition where VAT is imposed on all economic activities regardless of their purpose or end result and ensures that all economic operators, regardless of their legal form or structure have an equal competitive position. The deduction system on the other hand allows taxable persons to fully and immediately deduct input VAT against output VAT regardless of the number of the production stages involved in the process. It is neutral in respect to transactions, whatever their legal form might be⁵⁹.

From a system design perspective interpretation of concepts in the VAT Directive must reflect the principle of fiscal neutrality. In the context of VAT groups ‘neutral interpretation’ has been already achieved in the *Commission v Ireland* case where the ECJ held that “any persons” in art.11 should be interpreted literally and hence, non-taxable persons should be allowed to join VAT groups. To

⁵⁴ C. Bjerregaard Eskildsen, “VAT Grouping versus Freedom of Establishment”, *EC Tax Rev.* 2011-3, p. 115;

⁵⁵ C-97/09;

⁵⁶ For example: C-174/08 *NCC Construction Danmark*, paras 41-42;

⁵⁷ B. Terra and J. Kajus, 2011, *A Guide to the European VAT Directives. Introduction to European VAT. Vol 1.* Amsterdam/Hornbaek: IBFD, p.274;

⁵⁸ O. Henkow, “Neutrality of VAT for taxable persons: a new approach in European VAT?”, *EC Tax Review* 2008/5, p. 233;

⁵⁹ C-8/03 *BBL*, para. 36;

allow only taxable persons to form VAT groups would be to distort neutrality of legal form. Similarly, neutrality of competition is distorted when only some legal persons can benefit from group registration which seems to preclude any sectoral limitations or voluntariness of the group registration. It is only neutral that taxpayers which are in similar situations are treated in the same way. Therefore, limiting VAT groups to a certain sector, for example to a sector which carries exempt activities, would put at a disadvantage those sectors which also carry out exempt activities but cannot form a group to minimise their compliance burden. Likewise, when a MS treats group registration in an opt-in fashion it encourages registration of those businesses which will benefit from it. This undermines neutrality of legal form and distorts neutrality on an international scale where businesses with similar activities and structures get taxed differently depending on whether the MS of their establishment decided to first, adopt the grouping option and second, fully tax or exempt the activities in which the business is involved. It is therefore preferred that when VAT grouping option is exercised that such option is extended to all sectors of economic activity and that all connected persons are obliged to register regardless of whether they will benefit from it or not.

It is also pertinent that VAT rules are framed so that they do not influence business decisions regarding cross-border expansion of the business or the decision whether to outsource some activities or not⁶⁰. Therefore, ‘persons’ for the purposes of art.11 should be considered holistically and include all the foreign FEs in accordance with the judgement in *FCE Bank*. VAT grouping should not affect companies’ decision whether to carry out cross-border activity and hence, a ‘neutral interpretation’ takes “any persons” to mean “any persons *primarily* established...”.

Interpretation in the broader VAT regime context, especially from the perspective of the principle of neutrality, favours broad interpretation of the terms “any persons”. Businesses in similar situations should be treated the same way and VAT ought not influence the decision as to how to structure one’s business. Legal character of VAT requires that all economic operators are put on an equal footing and given equal opportunities. ‘Persons’ therefore mean ‘persons of all businesses’, ‘all persons’ and ‘persons in their totality’.

4.3. Historic interpretation

Legislative intent behind the words “any persons” can be found by tracing historical changes in the wording of what is currently art.11 from the moment the concept of VAT grouping crept into the legislation. The article derives from art.4 of the Sixth Directive which on the other hand derives from the Second Directive. The phrasing of the Second Directive used the words “separate taxable persons” to describe potential candidates for group registration. The wording has been however abandoned as the Sixth Directive came into place and the word “any” has substituted “separate taxable” in the English language version⁶¹. This semantic change goes beyond a stylistic change. The legislator deliberately dropped the words “separate” and “taxable” and inserted “any” instead. The words “any persons” gained a final stamp of approval when they were carried onto the current Recast Directive. The successive adding and subtracting as well as the preservation of the wording when a change was possible indicate an active choice on the part of the EU legislator who intended to widen the scope and open group registration to a wide range of actors.

⁶⁰ H. Kogels, “Making VAT as Neutral as Possible”, *EC Tax Review* 2012/5, p.231;

⁶¹ J. Swinkles, “The Phenomenon of VAT Groups under EU Law and Their VAT-Saving Aspects”, *International VAT Monitor*, January/February 2010, p.37-40;

4.4. Purposive interpretation - Objectives of art.11

The objectives of VAT grouping regulation can be found in the early documents which pre-date the actual introduction of VAT groups and in contemporary Union policy papers. Despite earlier appearances probably the most detailed and authoritative layout appears in the Explanatory Memorandum⁶² to the proposal which resulted in the adoption of the Sixth Directive (COM(73) 950) which holds that the purpose behind art.4 (now art.11) was to prevent companies which are organically connected to abuse the special enterprise scheme, to simplify administration and to realise the ‘substance over form’ rule in which technically separate, yet practically associated companies are seen as one in the eyes of the law. In spite the fact that VAT groups have outlived its purpose, i.e. the objectives have been fulfilled by other means for example by the introduction of the small enterprises scheme, it is important to ponder about groups in light of their initial context. Therefore, the author will first address the issue of whether VAT groups have been intended as a special scheme or a special person and then consider the wording of art.11 in light of its purpose and mischief.

4.4.1. VAT grouping as a special scheme/person

At the first glance it is visible that the Explanatory Memorandum does not mention that VAT groups were intended as a special scheme but as a simplification device. By reflecting economic reality VAT groups were intended to limit avoidance and give primacy to the substance of the arrangement, not the form. The Memo does not state explicitly that VAT groups were intended to be a special scheme.

The special scheme idea is also not supported when we analyze the directive itself. Firstly, the VAT group provision is found in Title III and not in Title XII which is devoted specifically to special schemes. All the six special schemes are kept together in the directive, presumably to exclude the possibility that any other provision not included in Title XII is to be taken for a special scheme. Moreover, it is in the nature of the special scheme that it contains more than one provision to regulate it, e.g. the special scheme for travel agents contains 5 articles whilst a scheme for investment gold contains 13. VAT groups are regulated by a single provision, not found in Title XII. In addition, the grouping provision is not a special scheme because contrary to special schemes it is not aimed at selected groups of taxpayers but has a general character. Neither the preparatory documents, nor the construction and logic of the directive evidence that VAT group option was intended as a scheme within the meaning of the VAT Directive. Even though the option has a facultative nature and constitutes a derogation just like special schemes do it does not subsume it under the special scheme section. Moreover, taxation or interpretation by analogy is not permitted⁶³. The interpretative consequences of treating VAT groups as special schemes or just mere derogations might be the same given the fact that special schemes, exemptions and derogations must be interpreted equally restrictively⁶⁴ but it is safe to conclude that VAT groups were not intended as a special scheme for the abovementioned reasons.

⁶² Proposal of 14 April 1965 for a Second Directive for the harmonization among Member States of turnover tax legislation, concerning the form and the methods of application of the common system of taxation on value added.

⁶³ O. Henkow, “Neutrality of VAT for taxable persons: a new approach in European VAT?”, *EC Tax Review* 2008/5, p. 240;

⁶⁴ For example: C-8/01 *Taksatorringen*, para. 36; C-472/03 *Arthur Andersen*, para. 24;

It is however conceivable that a VAT group is a special person. Yet, ECJ in the *Polysar*⁶⁵ case held that any collection of companies is not a group; VAT group is a structure not purely inferred from facts but something which has to be registered. As mentioned before, this view is maintained by the Commission who uses it to motivate various of its policies which if adopted, could lead to absurd results. To convincingly justify the position that group registration modifies the relationship between constituent members of the group and their foreign FEs without doing so with the domestic FEs a VAT group would have to indeed possess special qualities, far beyond the mere fact a VAT group is a *new* taxable person⁶⁶. In Commission's view point registration of a new taxable person is synonymous with a creation of a special taxable person. Interestingly enough, the Commission does not maintain the same stance with relation to registration of other new taxpayers other than groups and to registration of groups with exclusively domestic branches.

It is difficult to see why registration of a new taxpayer, even if previously registered at a different number, would give rise any special properties. VAT Directive does not provide that a change in registration number results in special rights or additional obligations to the taxpayer. If a special person in the form of a VAT group exists then its power to dissolve links between head offices and branches should be based on a criterium other than novelty. Moreover, the purpose of art.11 is to *bring together*, not *separate* companies. A group which cuts off, separates foreign FEs from the rest of the group certainly does not fulfill the grouping purpose. Finally, if art.11 indeed gives rise to a special taxable person the special rights and obligations of such a person would be outlined in detail in the directive itself. All the special taxable persons, like *Societas Europaea* or *Societas Privata Europaea*, have their precise and definite legal basis (although not in the VAT Directive)⁶⁷. The Directive would have stated clearly that art.11 is not subject to standard VAT rules and the ECJ, aware of such a special person, would have made an exception to *FCE Bank* in the judgement itself by excluding VAT groups from its scope (ECJ was not officially asked a question to that effect but had nevertheless a possibility to exclude groups from its scope). However, the judgement does not do so. Hence, both the legislator and the ECJ would have made reservations in the Directive and in case law had the art.11 indeed created a special person capable of changing relationship between groups and their organs. Therefore, neither a "single taxable person", nor a VAT group are special persons in the VAT Directive and hence, follow standard VAT rules and ECJ jurisdiction.

4.4.2. The meaning of "any persons" in light of the purpose of art.11

VAT grouping was designed with a purpose to simplify compliance and administration and prevent tax abuse. However, contrary to other VAT arrangements in the World, like the Australian⁶⁸, European VAT grouping's objective goes beyond administrative convenience and endeavors to give primacy to substance over legal form.

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⁶⁶ Communication from the Commission to the Council and the European Parliament on the VAT group option provided for in Article 11 of Council Directive 2006/112/EC on the common system of value added tax Brussels, 2.7.2009 COM (2009) 325 final, p.8;

⁶⁷ B. Terra and J. Kajus, 2011, *A Guide to the European VAT Directives. Introduction to European VAT. Vol 1.* Amsterdam/Hornbaek: IBFD, p. 424;

⁶⁸ A. Parolini *et al.* "VAT and Group Companies", *Bulletin for International Taxation*, June 2011, p.359;

The objective to simplify administration encourages restrictive interpretation of art.11 because administration becomes easier when few homogenous companies are grouped together. Expansive, broad reading of “any persons” means that all kinds of persons are included in a group which poses challenges to tax authority to supervise and manage heterogenous groups, especially in terms of ensuring proper deduction. Moreover, the ability to create cross-border groups puts pressure onto national tax authorities to get accustomed with foreign exemptions and deduction procedures to ensure proper deduction and prevent tax avoidance. Therefore, it can be argued that literal interpretation does not deliver results intended by the designer of the provisions; literal interpretation vitiates the purpose behind the wording.

However, if the ‘substance over form’ maxim is taken as an anchor point purposive interpretation becomes more in line with literal interpretation because of the appreciation for the fact that broad reading of “any persons” allows for the highest level of flexibility. Flexibility in interpretation on the other hand, accommodates the variety of legal arrangements which can be entered by the companies and see through them to the effect that groups can be formed by companies in different degrees of separation from each other. In other words, ‘substance over form’ manifests itself where interpretation captures the reality of legal situation and disregards the legal form in order to create a group. Therefore, “any persons” has a function to embrace, gather those persons in the group which are linked to each other. Putting it in the context of the whole provision art.11 - “any persons” do not have to be *immediately* connected to each other to form a group because the purpose behind the provision is to see through the legal arrangement and group companies which are connected regardless of what is the legal form in which the taxpayers decided to organise their affairs. Therefore, purposive interpretation would see “any persons” not as “any immediately connected persons” but simply (and in line with the literal interpretation) as “any persons”.

Moreover, as mentioned in section 4.4.1 the purpose behind art.11 is to bring companies together. The bringing together should therefore also disregard the degrees of separation between companies and enable the creation of groups even where the connection can be found via an intervening company (such as a foreign or domestic FE or a domestic holding company). Intervening companies should not break the chain between organically connected yet technically separate companies and therefore, should play a role in finding a connection for the purposes of creating the group. However, both the objective to group companies and the ambition to give precedence to substance over form do not presuppose the introduction of mandatory registration of VAT groups. It is true however that those aims would be realised better, and further underpin the principle of fiscal neutrality, if VAT grouping was mandatory in countries where the grouping option is exercised. It is because the concept of grouping disregards the possible advantages or disadvantages of group registration. Companies are grouped with a view to capture real structure of the company as opposed to an organizational order shaped by the legal regulations and not to maximise their competitive advantage. However, in light of the purposes behind art.11 we are unable to determine that VAT groups should be obligatory. It is sufficient to enable companies to group together for VAT purposes to fulfill the purpose.

To summarise, purposive interpretation of “any persons” warrants broad interpretation of the expression which has implication for how the provision should be read as a whole. In light of the above “any persons” should not be understood as “any immediately connected persons” but “any connected persons”. However, it is sufficient that the ‘persons’ can be grouped together to fulfill the purpose of the provision, they do not have to be grouped together to realise the ‘substance over form maxim’.

4.5. Interpretation in light of case law

The ECJ has on many occasions interpreted the concept of a ‘person’ for VAT purposes. We will now investigate in chronological order the most notable cases, *Heerma*⁶⁹, *HE*⁷⁰, *FCE Bank* and *Commission v Ireland*, to identify the properties of a “any persons” which derive from ECJ jurisprudence.

Heerma concerned a married couple who also formed a partnership for business purposes. Mr Heerma letted tangible property to the partnership. The ECJ considered whether he was acting independently or on behalf of a taxable person (the partnership) and remarked that a partnership which is a single taxable person has a *de facto* independence of a company⁷¹ different from individual economic autonomy of the partners to the membership who can, despite being jointly liable in the partnership, carry out economic activities independently. This judgement applied in the context of VAT groups leads to conclude that even though group members form a single taxable person they are not stripped from their ability to have individual economic activities and despite being bound by the group their individual structures remain intact when a group is registered. The partnership or a group is an add-on to the individual structures. This discredits Commission’s claims that VAT group registration changes group’s relationship with foreign FEs of constituent members of the group. A group, which is a new taxable person, has a *de facto* independence but it has no power to change the relationships within a group.

HE also concerned a spouse pursuing an economic activity. This time the ECJ held similarly, that the principle of neutrality requires that spouses who despite the lack of legal personality carry out economic activity and individually participate as recipients in the transaction in question can deduct input VAT when supplies are made for business purposes. In this case “any persons” (for the purposes of defining a taxable person) was interpreted as persons with legal personality or independent persons which is why relationship HE did not constitute a taxable person. It is important to observe that ECJ reiterates its reasoning from *Heerma* and focuses on neutrality of legal form when considering deduction.

Independence was again an important element in another judgement: *FCE Bank*. The ECJ held that a branch which does not have its own endowment capital, does not bear its own risks and which is dependent from the head office is not a separate taxable person from the head office. A single taxable person is hence characterised by the relationship of dependency. It also means that a taxable person might transcend borders and be a cross-border entity. It is remarkable that the ECJ has not limited the scope of the judgement to taxable persons which do not form groups and therefore this judgement applies to provisions across the directive. It follows then, that the concept of ‘establishment’ in art.11 should be influenced by the concept of a ‘person’ from *FCE Bank*, i.e. that to be established within the meaning of art.11 is to have a primary establishment in the country where the grouping option is exercised.

The recent development in *Commission v Ireland* unlike previous case law provides us with a concrete formulae for who is covered by the notion of a “any persons” in art.11. The Court held that

⁶⁹ C-23/98;

⁷⁰ C-25/03;

⁷¹ C-210/04 *FCE Bank*, para. 8;

the expression is broad and includes taxable, non-taxable and exempt persons. This interpretation is in line with the principle of neutrality because it does not affect the taxpayers choice of legal form.

According to ECJ a ‘person’ for the purposes of Title III of the Directive is an independent entity which might or might not have a legal personality (*Heerma, HE*). A ‘single taxable person’ can transcend borders (*FCE Bank*). Moreover, the registration of a new ‘single taxable person’ does not affect the structure and characteristics of the constituent members of the new person which they had before the new person was registered, e.g. a partner to the partnership is not precluded from making individual supplies to the partnership despite his participation in the partnership (*Heerma*). “Any persons” can be taxable, non-taxable or exempt as the concept is broad and reflects the principle of neutrality.

4.6. Tentative conclusions

It is clear from the literal reading of art.11, its legislative history, context and purpose that the expression “any persons” should be understood widely. The ‘person’ in art.11 can be therefore taxable, exempt or non-taxable, act in any economic sector, operate cross-border or on a purely domestic scale. A VAT group is however not a special taxable person and its properties do not extend beyond those of a ‘person’ in the meaning of the VAT Directive, i.e. VAT group does not change the relationship between the constituent members of the group and foreign FE of those members. Case law indicates that a ‘person’ should be an independent entity but it is not the legal form which is decisive.

Moreover, even though the expression has a qualitative and not quantitative character the purpose behind the wording might have a bearing on the issue of connectivity between group members. “Any persons” does not mean that ‘persons’ ought to be immediately connected to each other and hence allows that a group is formed of ‘persons’ who are separated by different degrees of separation. The expression however does not inform us about the size of the group because it does not have quantitative character.

5. Preferred Treatment

According to settled ECJ case law, the dispositions of the VAT Directive must be interpreted uniformly, where they do not explicitly provide room for interpretation by the Member States⁷², even when they are optional⁷³. The interpretation must respect the principles of neutrality and equal treatment and take into account relevant case law but most of all, observe the literal wording, context and purpose of provisions interpreted. Concepts of EU law have an autonomous meaning⁷⁴ different from the meaning in MS national laws and in the highly harmonised areas of law, such as VAT law, uniform interpretation is pivotal to guaranteeing effective maintenance of the VAT system. Uniformity of interpretation ensures that problems deriving from divergent implementation of provisions are either tackled straight away by removing interpretative mismatches or later, when uniform interpretation proves to be insufficient, by helping to identify areas in which legislative action is required and inspiring legislative changes. Now, we will investigate whether the proper

⁷² C-363/05 *JP Morgan*, paras 19–22;

⁷³ C-400/98 *Brigitte Breitsohl*, para. 48;

⁷⁴ For example: C-179/04 *Abbey National*, para. 23, C-242/08 *Swiss Re*, para. 33, C-240/99 *Skandia*, para.23;

interpretation of art.11 can help us solve problems with VAT grouping listed in section 3 and if not, which problems need to be addressed by other means.

Section 4.6 summarised what the preferred meaning of “any persons” is. There are no theoretical impediments to making VAT groups as open as possible. However, even though proper interpretation of the expression and art.11 offers solutions to some of the pertinent problems regarding VAT groups there are limitations to interpretation which call for legislative action to improve the working of the provision. Here, the author will look whether problems identified in section 3 can be solved by applying proper interpretation of art.11 and later, will present issues which require further redress.

5.1. Territoriality: Cross-border VAT groups

Although the interpretation of the terms ‘person’ or “any persons” for the purposes of art.11 RVD does not directly inform us about the meaning of ‘establishment’ within the meaning of the article it still has the capacity to influence the way we prefer it to be understood. A ‘person’ in VAT law is viewed in terms of its dependency while ‘establishment’ is a function of a person. A ‘person’ can transcend national boundaries, have legal personality or not but most importantly, does not use the concept of ‘establishment’ to define itself. It permeates from the VAT Directive that VAT group regulation must conform to ordinary rules laid down in the Directive and case law of the ECJ, especially the judgement in *FCE Bank*. It is also supported by the fundamental Treaty freedoms and the principle of neutrality that VAT group legislation does not privilege those taxpayers which operate on purely domestic basis than those which act cross-border. Therefore, against the Commission’s guidance, it follows that VAT groups ought to include foreign branches/FEs of companies established in the MS which exercised its freedom to transpose art.11 RVD. Such reading of a ‘person’ in VAT law clears out the doubt about the extent to which *FCE Bank* should be implemented and answers once and for all, that VAT groups ought to function cross border, especially in light of the evidence that VAT group regulations have a spill over effects which the territoriality criterium was meant to address but failed epically.

This is however not to say that cross-border VAT groups are not going to be problematic in their own right. Cross-border VAT grouping will render a choice not to permit VAT groups obsolete as FE held by a head office which entered a VAT group will have to be recognised by the MS as a member of the group. This double standard -- recognising that domestic branches of foreign head offices can form groups while domestic branches of domestic head offices cannot -- although still compatible with fundamental freedoms, will de facto force MS to recognise VAT groups against their will. On the practical side the things issues regarding mutual recognition of deductions and exemptions will militate against making VAT groups a fully workable structures. On top of that could groups could be used in avoidance or opportunistic channelling of services that might or might not include countries outside the EU. The exact implications of cross-border VAT groups need to be studied in great detail in a separate text but some solutions to problems foreseen might be available off the cuff. MS might introduce a deemed supply rule e.g. to redress situations in which a VAT group involves a member from outside the EU. Australia already does that by preserving Worldwide GST grouping while maintaining a rule that deems transactions from/to a foreign entity as taxable supplies⁷⁵. Moreover, it would be practicable to use a single deduction rate for the whole group to mitigate against channelling services from countries with a low deduction

⁷⁵ A. Parolini *et al.* “VAT and Group Companies”, *Bulletin for International Taxation*, June 2011, p.359;

rate to a country with a high deduction rate. Those are just the two examples of how further legislative action might be involved once it is accepted that the judgement in *FCE Bank* is to be fully embraced. Authors furnish further suggestions how the cross-border groups can be improved and/or transformed⁷⁶.

5.2. Voluntary nature

Analysing art.11 proved to be insufficient to resolve the issues related to the mode of registration of VAT groups. It remains in MS' discretion to introduce a compulsory or voluntary group registration. It follows however from the spirit of the EU as manifested in the *FCE Bank* case and from the general logic of VAT that a) companies should be able to establish abroad either by the way of primary or secondary establishment, b) divergencies in application of EU law, especially in highly harmonised areas such as VAT, are unwelcome because they distort internal market and undermine the principle of neutrality both on domestic and international scale. Therefore, we can draw a conclusion that it is preferred that VAT group become mandatory in those MS which transposed art. 11 into their national law. It would be moreover suggested that all MS adopt art.11 to stop tax competition and prevent infringements of national sovereignty caused by the (inevitable) spill-over effects of art.11.

In the event that VAT group registration becomes compulsory/automatic upon meeting further connective criteria from art.11 it becomes necessary to brace for and take legislative steps to address the following: a) VAT groups might become too big and/or difficult to manage, b) certain FEs might be automatically registered in two groups, c) problems regarding inadequately or vaguely defined "financial, economic and organisational links" which undermine legal certainty, d) problems with recognition of deductions.

5.3. Sectoral approach

The recent developments in ECJ case law in *Commission v Sweden* confirm what is clear from the terminology used in art.11 which prohibits any sectoral selectivity. "Any persons" within the meaning of the directive might come from different walks of business, as both literal, historical and purposive interpretations indicate. It is thus preferred that MS cease to implement art.11 selectively as it runs counter to the provision and the principle of neutrality.

5.4. Connectivity

The analysis of the expression "any persons" shows that the legislator attempted to realise the 'substance over form' principle. To achieve that a 'person' should be widely understood to accommodate the sheer variety of circumstances and legal arrangements taxpayers can enter into to organise their affairs and capture what could have been concealed in legal hurdles. From a theoretical viewpoint it should be irrelevant how the taxpayer structures his business, no legal technicality should break the connection between the organically connected parties. "Any persons" does not presuppose the immediate connection which is why from a theoretical standpoint foreign FEs of a head office which belongs to a VAT group should in principle be included in the economic link test. It is however not without relevance that allowing potentially indefinitely long chains of connections undermines the aim to simplify VAT administration process, a core purpose behind the

⁷⁶ K. Vyncke, "EU VAT Grouping from a Comparative Tax Law Perspective", *EC Tax Review* 2009/6, p. 308;

provision itself. So even though it would be more theoretically cohesive the common sense points of the conclusion that it is enough that persons *can* group together, as opposed to *having to* gather all the remotest, yet connected persons all over the EU. In conclusion, it is strongly suggested that the economic test from art.11 is elaborated on in greater detail to inform taxpayers, especially those who will face compulsory group registration. This might come at the expense of sacrificing the ideal of real control over the company but it enhances legal certainty.

6. Summary and Conclusions

It is conceivable that VAT groups are not the most effective way to deal with cooperation between connected parties. Some authors argue that European VAT should follow the Canadian example⁷⁷ and uniformly apply the art.132(1)(f) RVD exemption to cooperating companies instead of continuing to tolerate the faulty grouping provision. However, despite the problems generated by the current form of art.11 it is possible to bring VAT group to their full potential either by interpreting terminology in line with the general system of VAT or by adding new provisions to redress the remaining problems.

This paper has argued that the expression “any persons” should be interpreted widely for the purposes of the VAT Directive. Looking at the art.11 from the perspective of the preferred meaning of the expression it is clear that VAT groups should include foreign FEs of the members of the group and not be limited to any sector. It is preferred that when a MS exercises the VAT grouping option he does introduce compulsory registration but also takes precautions to avert the problems related to registration of groups which are too big to handle and promptly executes art.11(2) which encourages MS to adopt anti-avoidance measures. In light of the aforementioned the connective factors between groups should be laid out as clearly and precisely; FEs and foreign FEs should not be included in the connectivity test. Issues not resolved by preferred interpretation of art.11 can be address by the exercise of the deemed supply rule (issues related to the exercise of cross-border groups) or, in case of abuse, caught by the *Halifax* case.

⁷⁷ A. Parolini *et al.* “VAT and Group Companies”, *Bulletin for International Taxation*, June 2011, p.360;

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