VAT focus

VAT grouping: *Norddeutsche*, *Finanzamt T* and *Prudential*

Speed read

This article considers three recent decisions in the area of VAT groups: the CJEU judgments in *Norddeutsche* and *Finanzamt T*, and the Upper Tribunal judgment in *Prudential*. It summarises the latest guidance from the court and the tribunal on the applicable principles to consider when appointing the 'single taxable person', the concept of a group member as an entity carrying out independent economic activities, the VAT treatment of a provision of services between VAT group members, and the consequence when a VAT-grouped supplier of continuous services to a fellow member of the same VAT group leaves the group before the consideration for the supply is fully invoiced or paid.

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The concept of VAT groups is deceptively simple: to treat as a single taxable person a collection of persons closely bound by financial, economic and organisational links should be straightforward. Yet, as recent case law reveals, simple legislative wording does not always translate into straightforward outcomes in practice.

This article will look at three recent decisions in the area of VAT groups: the CJEU judgments in *Norddeutsche Gesellschaft für Diakonie mbH* (Case C-141/20) ('*Norddeutsche*') and *Finanzamt T* (Case C-269/20) ('*Finanzamt*'), and the Upper Tribunal judgment in *Prudential Assurance Company Ltd* v *HMRC* [2023] UKUT 54 (TCC) ('*Prudential*').

Norddeutsche

The CJEU's preliminary ruling concerned the interpretation of articles 4(1) and (4), and articles 21(1)(a) and (3), of the Sixth Directive.

Article 4(1) defines a 'taxable person' as 'any person who independently carries out in any place any economic activity specified in paragraph 2, whatever the purpose or results of that activity', whereas the second part of article 4(4) provides that 'subject to the consultations provided for in Article 29, each Member State may treat as a single taxable person persons established in the territory of the country who, while legally independent, are closely bound to one another by financial, economic and organisational links'. The language of article 4(4) is echoed in article 11 of the Principal VAT Directive.

Article 21(1)(a) provides that, in the first place, VAT is the liability of the taxable person carrying out the taxable supply of goods or of services. Article 21(3) then permits member states to 'provide that someone other than the person liable for payment of the tax shall be held jointly and severally liable for payment of the tax'.

The first question before the CJEU was whether the second sub-paragraph of article 4(4) of the Sixth Directive must be interpreted as precluding a member state from designating, as a single taxable person for VAT purposes, not the VAT group itself, but a member of that group, namely the controlling company of that group.

The court held, by reference to *Ampliscientifica and Amplifin* (Case C-162/07) at paras 19 and 20, that the effect of implementing the VAT group scheme is that group members are no longer to be treated as separate taxable persons within the meaning of article 4(1) of the Sixth Directive but are to be treated as a single taxable person, with a single VAT number to be allocated to the group.

As to whether the second sub-paragraph of article 4(4) of the Sixth Directive precluded the German practice of designating, as a single taxable person, not the VAT group itself but a member of that group, namely its controlling company, the court found that, where several legally independent members of a VAT group together constitute a single taxable person, there must be a single interlocutor, which assumes the group's VAT obligations vis-à-vis the tax authorities. In that regard, as well as the possibility of providing for a representation of the VAT group by one of its members, the court found that the controlling company of the VAT group could be designated as a single taxable person, where that controlling company is in a position to impose its will on the other entities forming part of that group, to ensure the correct levying of VAT and provided that such an arrangement does not entail a risk of tax losses.

> The court noted that the benefit of the VAT group scheme cannot be reserved only to entities in a relationship of subordination with the controlling company of the group

The third question before the CJEU (the court having found it unnecessary to answer the second question) was whether the second sub-paragraph of article 4(4) of the Sixth Directive must be interpreted as precluding national legislation which makes the possibility for a given entity to form, with the undertaking of the controlling company, a VAT group conditional upon that controlling company having, in that entity, a majority of the voting rights in addition to a majority holding in the share capital of that entity.

The court held that it is important, for the uniform application of the Sixth Directive, that the concept of 'close financial links' is given an autonomous and uniform interpretation, whilst noting that it cannot be interpreted narrowly and that member states have a margin of discretion to impose conditions to prevent abusive practices and behaviour or to combat tax evasion or tax avoidance, provided that EU law principles of proportionality and fiscal neutrality are respected.

More specifically, the court noted that, in principle, the benefit of the VAT group scheme cannot be reserved only to entities in a relationship of subordination with the controlling company of the group. Thus, the German legislative requirement for a majority of voting rights, in addition to the requirement relating to a majority shareholding, to qualify for VAT grouping does not, *a priori*, constitute a necessary and appropriate measure for attaining

the objectives of preventing abusive practices or behaviour or of combating tax evasion or tax avoidance.

The fourth question for the court was whether article 4(4) of the Sixth Directive, read in conjunction with the first sub-paragraph of article 4(1), must be interpreted as precluding a member state from classifying given entities as non-independent, where those entities are integrated, in financial, economic and organisational terms, into the controlling company of a VAT group.

The court referred to the Commission's statement that 'a VAT group could be described as a "fiction" created for VAT purposes, where economic substance is given precedence over legal form … Whilst each member of the group retains its own legal form, for VAT purposes only, the formation of the VAT group is given precedence over legal forms according to e.g. civil law or company law'.

Leading on from the settled case law that a supply of services is taxable only if there exists between the supplier and the recipient a legal relationship in which there is a reciprocal performance, the court held that such a legal relationship could exist between one member of a VAT group and the other members of that group where the first member carries out an independent economic activity. An entity may be regarded as being independent in this regard, held the court, where it performs its activities in its own name, on its own behalf and under its own responsibility and, in particular, in that it bears the economic risk arising from its business. In other words, it did not follow from the second sub-para of article 4(4) that an entity would cease to carry out independent economic activities, for the purposes of the first sub-paragraph of article 4(4), solely because it belongs to a VAT group.

The CJEU's judgment in *Norddeutsche* does not therefore undermine the UK's domestic approach of appointing a single VAT group member as the representative member, without requiring that that representative member controls the other members.

As to the interplay between the UK's domestic provision that disregards intra-group supplies and what the CJEU has said about the potential for a legal relationship between members of the same VAT group, one notes that the CJEU does not consider its answer to the fourth question to be anything other than consistent with its confirmation, when considering the first question, that VAT group members are no longer to be treated as separate taxable persons.

Finanzamt

The CJEU, comprised of the same judges, released its judgment in *Finanzamt* on the same day as *Norddeutsche*, and the issues in the two cases overlap.

Indeed, the first question considered by the court in *Finanzamt* is identical to the first question in *Norddeutsche* and, unsurprisingly, the court follows the same reasoning to reach the same conclusion.

The second issue in *Finanzamt* arose from the fact that the single taxable person (the 'representative member') of the VAT group in that case carried out both economic activities, for which it was a taxable person, and activities in the exercise of its powers as a public authority, in respect of which it was not a taxable person liable for VAT under article 4(5) of the Sixth Directive. The question was whether the provision of services by another member of the VAT group in connection with the single taxable person's exercise of its powers as a public authority must be regarded as a provision of services falling within the field of economic activity of the single taxable person and intended for its field of activity as a public authority, such that it is taxable under article 6(2)(b) of the Sixth Directive (which treats as supplies of services for consideration 'supplies of services carried out free of charge by the taxable person for his own private use or that of his staff or more generally for purposes other than those of his business').

The court confirmed that article 6(2)(b) was not intended to establish a rule that transactions outside the scope of the system of VAT may be considered to be carried out for 'purposes other than' those of the business within the meaning of that provision. Rather, that article is intended to prevent a taxable person or members of his or her staff from obtaining, free of tax, services provided by the taxable person for which a private individual would have to have paid VAT.

On that basis, the court concluded that, where a single taxable person of a VAT group receives a supply of services by an entity belonging to that group intended for its field of activity as a public authority, that supply could not be considered taxable under article 6(2)(b) of the Sixth Directive. To hold otherwise would amount to rendering both article 2(1) and article 4(5) of the Sixth Directive meaningless.

> Where a single taxable person of a VAT group receives a supply of services by an entity belonging to that group intended for its field of activity as a public authority, that supply could not be considered taxable

On the facts of the particular case, the court also noted that article 6(2)(b) of the Sixth Directive related only to transactions effected 'free of charge', and could not apply where financial consideration had been provided by the controlling company for the cleaning services carried out by the group member, whether in the context of its field of economic activity or in the context of its activity as a public authority.

The court's judgment on issue two echoes both Advocate-General Jääskinen's view in *Commission* v *Ireland* (Case C-85/11) that 'the VAT group's internal transactions do not exist for VAT purposes', and the court's confirmation in *Ampliscientifica* that the effect of implementing the VAT group scheme is that group members are no longer to be treated as separate taxable persons. In light of this, it is doubtful that the same judges, by their answer to the fourth question in *Norddeutsche*, had meant that the potential for a legal relationship between members of the same VAT group could give rise to a taxable supply.

Prudential

The case of *Prudential* explores the concept of the single taxable person in the context of a group break-up.

Whereas the First-tier Tribunal held that no VAT was due on the value of the consideration for a supply that, in real life, took place when the supplier and recipient were members of the same VAT group ([2021] UKFTT 50 (TC)), the Upper Tribunal reversed that decision. The fact in *Prudential* that allowed it to do so was that the supply was a continuous supply of services which, held the Upper Tribunal, meant that, on applying reg 90 of the VAT Regulations, SI 1995/2518, each occasion on which a VAT invoice was issued or a payment made in the period after

the supplier had left the VAT group triggered a 'supply' that could not be disregarded under VATA 1994 s 43(1)(a).

The First-tier Tribunal had found for Prudential on the basis that, although reg 90(1) had to be applied, throughout the group period the supplier's business had to be treated, pursuant to s 43(1), as carried on by the representative member of the VAT group (which was the recipient). That meant there was no supply by the supplier 'in the course or furtherance of its business', whether at the time of the actual supplies or (because regulation 90 does not deem there to be a new business) at the later time of the deemed supplies. It follows that no VAT was chargeable. The First-tier Tribunal also held that *Prudential* could not be distinguished from *B J Rice* [1996] STC 581, in which the Court of Appeal held that no VAT was chargeable where the supplier was not a taxable person at the time of the real-world supply, notwithstanding the application of (what is now) reg 90.

VAT-grouped businesses should be alert to the possibility that HMRC will seek to assess VAT on amounts invoiced or paid in a period when supplier and recipient are no longer members of the same VAT group, even if they had been so when the real-world transactions took place

The Upper Tribunal disagreed with the First-tier Tribunal and took a more restrictive view of *B J Rice*. Nor was it persuaded by an example given in *Thorn Materials Supply Ltd and another* [1998] UKHL 23, where Lord Nolan held that the VAT charged on a pre-payment for a supply of goods would have to be refunded in the event that the supplier and recipient become VAT grouped before title in the goods is transferred.

Finally, the Upper Tribunal did not appear to consider the fact that article 66 of the Principal VAT Directive, under which the UK enacted reg 90, permitted member states to derogate from earlier articles (which provide that the time of performance determines whether there is a chargeable event and when VAT becomes chargeable) only as regards when 'VAT is to become chargeable' and not when the chargeable event occurs.

By its reasoning, the Upper Tribunal essentially found the existence of the VAT group to be irrelevant.

As matters stand, VAT-grouped businesses and those advising them should be alert to the possibility that HMRC will seek to assess VAT on amounts invoiced or paid in a period when supplier and recipient are no longer members of the same VAT group, even if they had been so when the real-world transactions took place. Businesses may wish to maintain the existing VAT group structure until all payments for intra-group supplies have been made. If that is not possible or practicable, businesses should consider agreeing clear terms as to which entity will ultimately bear the economic burden of any VAT liability, even though it may seem odd to do so where the real-world transactions are completed intra-group. ■

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- The VAT review for March 2022 (J Crookshank & G Barnett, 3.3.22)