

VAT DUTIES AND INDIRECT TAX LAW

GOOD NEWS FOR ALL VAT GROUPS

ADVOCATE GENERAL ENDORSES THE PRINCIPLE OF INCLUDING NON-TAXABLE PERSONS IN VAT GROUPS

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(1) The Advocate General's opinion in summary

1. Advocate General Jaaskinen released his opinion today in Case C-85/11 *EC v Ireland*. He has concluded that the practice of permitting non-taxable persons to be members of a VAT Group does not infringe the Principal VAT Directive or any EU principle.

(2) Why is an Irish case relevant to the UK?

2. The Irish case was heard at the same time as Case C-86/11 *EC v UK* and other similar infraction proceedings brought by the Commission against the Czech Republic, Denmark, Finland, Sweden and the Netherlands. The European Court asked for only one opinion to be produced ahead of its judgment on the basis that the same point of principle arises in each case. This opinion therefore applies equally to the VAT Act and HMRC's long-held practice of allowing non-taxable persons to belong to VAT groups.

(3) When can judgment be expected?

3. Judgment is expected in 2013. Given the robust and comprehensive opinion of the Advocate General, taxpayers can feel confident of a favourable outcome.

(4) What concerned the Commission?

4. The Commission was concerned that in principle a VAT group could be made up of only non-taxable persons. As an exception to the general rule that each taxable person is to be treated as a separate unit, Article 11 of the Principal VAT Directive should be construed narrowly by construing the reference to "persons" as a reference to taxable persons. It also claimed that the Advocate General's opinions in *Ampliscientifica* and *Polysar* supported such a narrow approach.

Finally, the Commission was concerned about abuse and a breach of the principle of fiscal neutrality by reason of the advantages afforded to non-taxable persons within a VAT group which were not available to non-taxable persons outside of a VAT group.

(5) What was the basis of the Advocate General's opinion?

(a) Legislative history and wording

5. The Advocate General considered the legislative history between paragraphs 28 and 34. He noted that Annex A to the Second VAT Directive referred to "separate taxable persons". The use of the word "separate" implied that Member States had a choice of treating taxable persons separately or as one taxable person. No such reference can be found in either the Sixth Directive or in the Principal VAT Directive, from which it could be implied that the legislature wanted to broaden the scope of those who may form part of a VAT group.

6. At paragraph 35 the Advocate General dismissed the Commission's concerns about VAT groups comprising only non-taxable persons as hypothetical. All supplies between non-taxable persons fall outside the scope of VAT whether they form a VAT group or not.

7. The principle of legal certainty also played a part in the Advocate General's reasoning. See paragraph 36. Article 11 refers to persons not taxable persons. Tax authorities and taxable persons are entitled to rely upon that clear wording.

(b) The objective and context of the VAT grouping provisions

8. The only objective of the VAT grouping provision is to simplify administration or combat abuse in cases where "independence" between formally legal entities is a purely legal technicality. (See the Explanatory Memorandum to the Proposal for the Sixth Directive).

(c) The broader context of the VAT regime

9. VAT grouping neither introduces limitations nor broadens the rights of a taxable person as defined by Article 9. The right to deduct input tax is therefore the same whether within or outwith a VAT group. See paragraphs 42 to 43.

(d) The purpose of the VAT grouping provisions – outsourcing IT services to a subsidiary

10. In the light of the purpose of the VAT grouping provisions, the Advocate General recognised that VAT grouping may entail cash flow advantages for taxable traders. But that is an inevitable consequence of the fiscal policy choice made by Member States. See paragraph 45-7.

(e) Out-sourcing

11. Paragraph 48 will be of interest to banks and the financial services sector:

"Where an economic operator is not entitled to deduct input VAT incurred in a purchase, it might be economically advantageous for it to produce the goods or services itself. For example, a bank that is not entitled to deduct VAT might benefit economically if it produces IT services needed for its banking activities internally rather than buying them from a third party. However, if the VAT grouping option is available, it may outsource its IT service provision to a subsidiary belonging to the group and still gain the same advantage."

12. The Advocate General recognised that VAT liability can and does have an impact on the structure and functioning of business activities. It may also be used to achieve parity with corporate structures which achieve the same fiscal or economic benefits, such as holding companies with major shareholdings in all other companies of the group.

(f) Fiscal neutrality

13. VAT grouping supports fiscal neutrality. The Advocate General rightly points out at paragraph 53 that the inclusion of non taxable persons in a VAT group makes no difference to the pursuit of the goals of the VAT grouping regime. A situation in which a non taxable person benefits economically by making VAT free purchases within a VAT group is no different from the situation in which a taxable person engaged in VAT exempt activities may, by belonging to a VAT group, purchase taxable supplies VAT free from within the VAT group. There is no anomaly. In each example, the persons under consideration (including the non-taxable persons) are regulated by the EU VAT Regime.

(6) What next for the UK?

14. HMRC and taxpayers can expect a judgment in early 2013. Both should feel optimistic that the Court will follow the Advocate General's conclusion in the UK proceedings, though it may not adopt all of his reasoning. But overall, there is cause for optimism that the UK legislation on VAT Grouping will not have to be amended.

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Melanie Hall QC represented the UK in virtually identical proceedings heard at the same time as *EC v Ireland*.