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Independent Group of Persons: Decision of the Court of Justice of the European Union

4 May 2017

On 4 May 2017, the Court of Justice of the European Union (the Court) rendered its judgement in Case C-274/15 *European Commission v Luxembourg*. In this judgement, the Court essentially upholds the infraction proceedings brought by the Commission against Luxembourg and declares that the Luxembourg legislative regime determining the application of the VAT exemption for independent groups of persons does not comply with the VAT Directive. The decision of the Court is in line with the conclusions of the Advocate General (AG) which were released on 6 October 2016.

Background

The European Commission raised a challenge towards Luxembourg's transposition of the VAT exemption provided for supplies of services rendered by independent group of persons (IGP) to their members under Article 132(1)(f) of the EC VAT Directive 2006/112. This exemption is also often referred to as the 'cost-sharing exemption'.

Article 132(1)(f) of the VAT Directive directs Member States to exempt from VAT: *"the supply of services by independent groups of persons, who are carrying on an activity which is exempt from VAT or in relation to which they are not taxable persons, for the purpose of rendering their members the services directly necessary for the exercise of that activity, where those groups merely claim from their members exact reimbursement of their share of the joint expenses, provided that such exemption is not likely to cause distortion of competition"* (the IGP exemption).

The IGP exemption is of interest for taxable persons performing exempt activities, such as banks, insurance companies, and hospitals or for non-taxable persons such as not-for-profit organisations or public bodies, which would like to group together with similar taxable persons for the purposes of sharing certain resources. For example, a group of hospitals may wish to collectively acquire and exploit expensive medical equipment, or a group of banks may seek to centralise their IT support services in an ad-hoc structure external to any one group member. Without the IGP exemption, any ad-hoc external structure holding the centralised resources would be required to apply VAT to its supplies of the use of those resources to the group members which, taking into account the VAT exempt or non-business activities thereof would be a final cost for those members (at least partially, if not fully).

Since its introduction, the IGP exemption has been widely used by taxable persons operating in the financial sector as well as by not-for-profit organisations in

several EU Member States. The lack of specific details in the VAT Directive regarding the conditions for the application of this exemption, however, has resulted in the Member States foreseeing very different conditions in their implementation of national IGP regimes, some of which rendered the exercise of the IGP exemption impracticable. This under-use of the IGP exemption in Member

States which established overly-restrictive IGP regime, or Member States which simply provided insufficient guidance for the exemption's application was highlighted and deplored by the Commission in a 2010 document[1]. It was thus somewhat of a surprise when the Commission went on to challenge Luxembourg's IGP regime, ultimately bringing an infringement case before the Court, given that this regime was designed to enable the IGP exemption to act as a flexible and practical tool for the sharing of costs and resources.

In addition to the infringement case brought against Luxembourg, it is worth noting that three further cases addressing different aspects of the IGP exemption are currently pending before the Court:

1) *European Commission v Federal Republic of Germany* (C-274/15): another infringement action brought by the Commission, which considers that Germany has wrongly implemented the VAT Directive by limiting the IGP exemption to groups of persons active in the medical sector only.

   Advocate General Wathelet released his conclusions in this matter on 5 April 2017, finding Germany's restriction to the scope of the IGP exemption did, indeed, infringe its obligations under the VAT Directive.

2) Aviva (C-326/15): in this case, the two main questions to the Court are:

   a) What criteria should be applied in assessing whether the condition of absence of distortion of competition laid down in Article 132 (1)(f) is fulfilled?

   b) Is the answer to this question affected by the fact that the IGP provides services to Members established in different Member States?

   On 1st March 2017, the Advocate General Kokott opined that a Member State has the right to implement the IGP exemption without specific reference to the distortion of competition. Furthermore, in light of the challenges assessing distortions of competition on a cross-border basis, the IGP exemption should only be applicable to IGPs with members confirmed to a single EU Member State. Finally, whilst the question was not raised in this case, the AG further stated that the IGP exemption should be restricted to groups of members undertaking activities in the public interest, this excluding automatically any use of this exemption by taxable persons within financial sector.

3) *DNB Banka* (C-326/15), in this case, the main questions are:

   a) Could the IGP exemption apply where members of the IGP are established in different Member States and where, as a result of differences in the implementation of the IGP exemption between the relevant Member States, the members in one Member State do not meet the conditions set down in the other Member States?

[1] Commission staff working document accompanying the Green Paper on the future of VAT, SEC (2010) 1455, 1st December 2010,

b) Must the IGP be a separate legal entity from its members?

c) Could an IGP apply a 'mark-up' to its services to the extent that such a mark-up is imposed by direct tax law?

In her conclusions released 1 March 2017, Advocate General Kokott declined to address the first question directly, rather making reference to her earlier conclusions in Aviva, and as she had done in those earlier conclusions, despite the matter not having been raised in the case she repeated her assertion that the IGP exemption is not available for the financial sector. On the two other questions raised, the AG answered that an IGP does not need to be a distinct legal entity, but is required to be a taxable person for VAT purposes and that a mark-up could not be applied in for any reason.

The Ruling of the Court

1. Services directly necessary to exempt or out of scope activities

Under the Luxembourg IGP regime, members of the IGP could perform taxed activities in addition to their VAT exempt or non-business activities, to the extent that the taxed activities generated no more than 30% of their turnover. This rule was introduced because many taxable persons in both the financial and not-for-profit sectors undertake some activities subject to VAT. It is worth noting, for example, that the Belgian and French IGP regimes also allow similar thresholds of taxable turnover (respectively 10% and 20%).

Advocate General Kokott concluded that an IGP could only exempt its supplies of services to the extent that these are directly necessary for the exempt or out of the scope activities undertaken by its members. The AG gave the example of, on the one hand, accounting services that would be used for the global activity of the members, and on the other, supplies of the use of medical machinery that would be used in the direct provision of exempt medical services by the members. According to the AG, the IGP exemption could be available only in the second situation.

The Court finds that, according to the clear wording of the VAT Directive, only services rendered by an IGP to its members which are directly necessary for the exercise of their exempt (or non-business) activities can be exempted from VAT under the IGP exemption. Contrary to the submissions of Luxembourg in respect of this challenge, the Court does not consider the restriction of the IGP exemption in this manner to deprive the exemption of its intended effect. Rather, although it held that *"the application of [the IGP] exemption is not restricted to groups whose members exercise exclusively an activity which is exempt from VAT or in relation to which they are not taxable persons"* it considered that in such cases the exemption only applied to the supplies made by the IGP of *"services [which] are directly necessary for those members' exempt activities or activities in relation to which they are not taxable persons."*

2. Possibility for the members to recover VAT incurred by the IGP

The Luxembourg IGP regime allowed members to recover the VAT incurred by the IGP on its costs, in line with each members' own VAT deduction right and their share of the services performed by the IGP. This specific rule aims to create a perfect neutrality of the tax. In support of this aspect of its IGP regime, Luxembourg relied on the CJEU's earlier ruling in PPG[2] , where the Court considered a taxable person to have the right to recover the VAT incurred by a pension fund which it had set up for its employees.

[2] PPG Holdings, C-26/12, 18 July 2013.

In her conclusions, the AG considered that a member could not recover the VAT on costs incurred by the IGP because the IGP, as a separate taxable person, is the beneficiary of the supply and not the members themselves.

The Court once again followed the AG, agreeing that the IGP must be an independent taxable person in order to make supplies of services to its members and VAT incurred on supplies rendered for the benefit of the IGP, therefore, could not be deductible by its members.

3. Contributions by the members to the IGP

The Luxembourg IGP regime also permitted the members of an IGP to acquire goods and services in their own name, but on behalf of the IGP, and enabled the subsequent transfer of those goods and services to the IGP to be outside the scope of VAT.

Again recalling the independence of the IGP from its members, the AG did not consider it possible for goods and services acquired in the name of the members to be transferred to the IGP without VAT being applied.

This conclusion was also confirmed by the Court, which echoed her arguments that the transfer of goods and services between independent taxable persons must fall within the scope of VAT.

Comments

The decision of the Court in this case represents a substantial restriction of the scope of application of the IGP exemption that is expected to make the use of this exemption in a number of situations significantly more difficult or, at worst, wholly unworkable.

One positive aspect of the Court's ruling, however, is that it does not restrict the application of the IGP exemption to groups of members undertaking only exempt activities or activities outside the scope of VAT. The Court, therefore, has left the door open in respect of the application of the IGP exemption to groups of members who undertake taxable activities alongside their exempt or non-business activities. The Court did not specifically address the sectors in which members of an IGP could operate in this case. Its rejection of the AG's more restrictive view of the permitted activities of the members, however, might be seen as a confirmation that the IGP exemption should be available to all sectors (including financial services), contrary to AG Kokott's conclusions in Aviva and DNB Banka and in line with AG Wathelet's conclusions in *Commission v Germany*.

In practice, however, it would probably be extremely difficult to ensure that the exempt services rendered by an IGP are used exclusively for exempt or out of the scope activities of its members. Indeed, the current practice in Luxembourg is for IGPs to make supplies of administrative, accounting, IT, HR services that are used by the members for both their exempt or non-business activities and their taxable activities. This substantial restriction of the scope of application of the IGP exemption will, furthermore, not only have an impact in Luxembourg, but also in many other Member States applying similar regimes. It is difficult to see, therefore, how this ruling could satisfy the above-mentioned wishes of the European Commission to see the IGP exemption more broadly used.

Any organisation currently benefitting from the IGP exemption within the EU should be aware of this case and should monitor its potential impact, including the

seeking of alternative arrangements which might enable the preservation of their current VAT position.

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