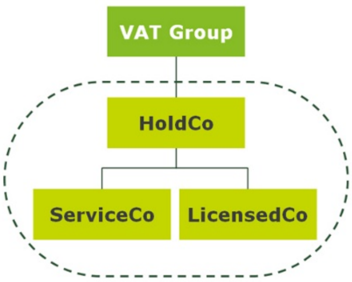
Introduction of VAT Grouping in Malta

By Chris Borg and Samantha Abela

In his 2018 Malta Budget Speech on 9 October 2017, the Minister of Finance announced the introduction of VAT Grouping as a means of encouraging sustainable growth in the licenced financial services and gaming industries. From a tax perspective, this was probably one of the most interesting announcements in this Budget Speech. While the concept of VAT Grouping has existed in some shape or form within the European Union (EU) context since at least the 1960s, for Malta this will be an entirely novel concept. Therefore, while the proposed text of the legislation is not available at this stage, we can expect a new VAT paradigm and new opportunities for those entities that will qualify for and opt to use VAT Grouping.

What is VAT Grouping?

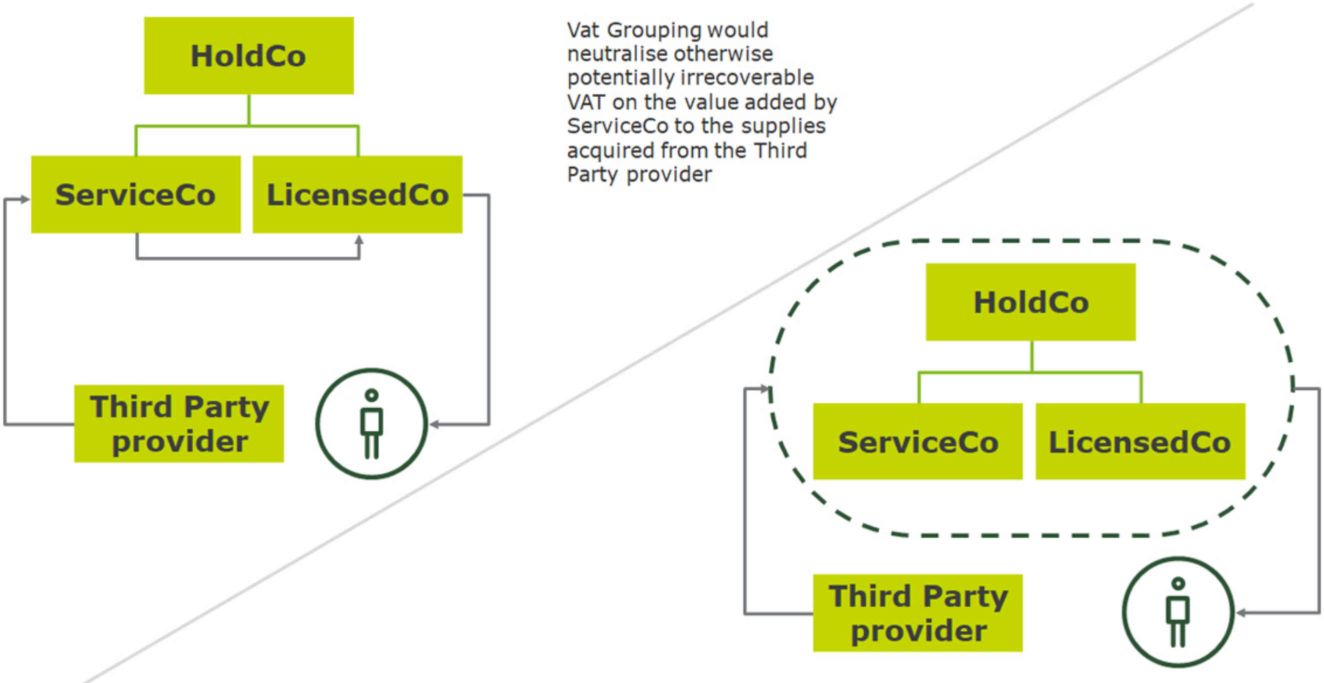


At EU level, VAT Grouping is provided for in Article 11 of the EU VAT Directive, which is an optional clause that Member States might wish to use, as opposed to a mandatory clause that they are compelled to apply. This option essentially provides a possibility for a Member State to treat two or more persons who - while legally independent - are closely bound to one another by financial, economic and organisational links, as a single taxable person for VAT purposes. In the case of a group of companies, at law each company constitutes a separate legal person. However, in the context of a VAT Group, that group of companies would be regarded as a single taxpayer for VAT purposes.

What are the advantages of VAT Grouping?

- VAT Grouping tends to be a means of simplifying the administrative and compliance burden for both tax authorities and businesses, in the sense that typically only one consolidated VAT return for the VAT Group as a whole would need to be submitted.
- Being part of a VAT Group can also provide VAT cash flow advantages because the input VAT claims attributable to certain members of the group are credited against the output VAT debts of other members, which in turn reduces the amount of VAT refunds and related administration for the tax authorities.
- VAT Grouping may also provide additional financial security for the tax authorities, because in certain countries members of the VAT Group may be held jointly and severally liable for the payment of VAT dues of the VAT Group as a whole.

- For businesses that make exempt (without credit) supplies - such as operators in the financial, insurance and gaming sectors, which the Minister announced would be the target candidates for VAT Grouping in Malta – these would typically enjoy a limited right (if indeed any) to recover input VAT incurred on their purchases. In this context, VAT Grouping can provide absolute VAT cost savings by preventing the cascading of irrecoverable VAT costs on charges made between members of the VAT Group.



Is VAT Grouping standardised across the EU?

While not all EU Member States have adopted VAT Grouping, it has already been implemented by a majority of Member States, and its take up is expected to increase in the near future.

In some Member States such as France and Portugal, cost-sharing groups have traditionally been used as a proxy for VAT Grouping. Other countries have adopted some variation of grouping or consolidation for VAT purposes. For example, France adopted a consolidation mechanism whereby taxpayers may elect, under specific conditions, to consolidate the payment of VAT, but not their VAT returns. Moreover, transactions between the members of the consolidated group remain subject to VAT under the normal VAT rules. Similar to France, Italy adopts a compensation mechanism whereby companies belonging to a group are allowed to pool together their VAT payment and refund positions, while each group entity retains its own VAT identification number and furthermore intra-group transactions are not disregarded for VAT purposes, as they would in full-fledged VAT Grouping. Having said this, Italy is fast approaching the full introduction of proper VAT Grouping with effect from 1 January 2018.

With the recent judgments of the Court of Justice of the EU such as in the Aviva and DNB Banka cases, which have held that the EU VAT cost-sharing exemption applies only to VAT exempt transactions in the public interest and not to financial services and insurance, it appears that countries which have traditionally relied on the cost-sharing exemption to mitigate the cascading of irrecoverable VAT costs in the financial services industry will likely also resort to VAT Grouping as an alternative solution to cost-sharing groups for the financial and insurance sectors.

The application of VAT Grouping provisions varies widely across the EU Member States that have chosen to implement it so far, as the wording of Article 11 of the EU VAT Directive leaves it up to the Member States to lay down the detailed rules on implementation.

The wording of Article 11 of the EU VAT Directive appears to allow Member States to choose to allow non-taxable persons, such as pure holding companies, to form part of a VAT Group. In its case law, the Court of Justice of the EU has confirmed that the term 'person' should be interpreted in its literal and broadest sense and as such, non-taxable persons may legitimately be allowed to join VAT Groups in line with the EU VAT Directive. This conclusion does not imply, however, that Member States are obliged to open their national VAT Grouping regimes to non-taxable persons even if they do not wish to do so. It will be interesting to see whether Malta adopts this approach of allowing non-taxable persons to form part of a VAT Group.

Moreover, in some Member States, the use of VAT Grouping is not optional for businesses but indeed mandatory. For example, in Germany, if one or more entities are integrated financially, economically and organisationally into the business of a German parent entity, these entities, including the parent entity, automatically form a VAT Group. We do not expect Malta to follow the German model in this respect – indeed, the Minister's Budget announcement on VAT Grouping seemed to suggest that, as in several other Member States, VAT Grouping would be an elective option rather than mandatory for the relevant businesses in Malta.

According to the Budget Speech, VAT Grouping in Malta will be limited sectorally to regulated business such as gaming, insurance and financial services. A similar type of sectoral limitation was endorsed by the Court of Justice of the EU in the *Commission vs Sweden* case, where it was held that the Swedish VAT Grouping rules were acceptable and within the margin of discretion allowed by the VAT Directive, since the rules legitimately sought to prevent tax abuse and avoidance.

The way forwards

VAT Grouping will be a new reality within the Maltese tax system in the near future. It is not yet known exactly when it will be implemented, or indeed how it will work in detail. We will of course know more when the proposed legislation is published. Even so, it is expected to be an important tool that could generate interesting potential benefits both for the Maltese tax authorities as well as for business operators in the licenced financial services and gaming industries. Limiting the cascade effect of irrecoverable VAT is likely to be a particularly attractive feature for these important sectors of the Maltese economy, in turn enhancing VAT neutrality and hence improving the way Malta's VAT system works within these key sectors.

Chris Borg
Indirect Tax Principal
cborg@deloitte.com.mt
+356 2343 2000

Samantha Abela
Indirect Tax Manager
saabela@deloitte.com.mt
+356 2343 2000

www.deloitte.com/mt

Deloitte
Deloitte Place
Mriehel Bypass
Mriehel BKR 3000
Malta