The Luxembourg cost-sharing VAT exemption is too wide, says EU Court

5 May 2017

In brief

The Court of Justice of the European Union released its decision in the first of a series of cases on the “independent group of persons” (also referred to as the cost-sharing VAT exemption). In *Commission v Luxembourg* (C-274/15), the Court looked at the VAT rules implemented by Luxembourg for this specific VAT exemption.

In its judgment, the Court upholds the Commission’s action against Luxembourg and considers that the rules implemented by Luxembourg do not comply with the EU VAT Directive.

The Luxembourg cost-sharing VAT exemption as we know it today is not jeopardised as such but some of its implementing measures will have to be amended. The Luxembourg authorities will now need to come up with a new legal and practical framework for this VAT exemption to still work in the future. It is now also time for groups which currently use this VAT exemption to review their position and consider alternative solutions. Groups who have hesitated to implement the cost-sharing exemption due to the uncertainty, may now want to consider it again when revised rules will be drafted. But more is still to come with the other three cases relating to this VAT exemption still pending with the Court.

In detail

Background

Article 132.1.f of the EU VAT Directive, transposed in Article 44.1.y of the Luxembourg VAT Law, provides that the cost-sharing VAT exemption applies to services of those groups to their members if some conditions are met.

The scope of this VAT exemption has been clarified in two grand-ducal decrees dated 21 January 2004 and 7 August 2012, as well as in a circular letter from the VAT authorities (Circular Letter No. 707 of 29 January 2004).

Taking the position that the set of rules implemented by Luxembourg in relation to this specific VAT exemption is not compatible with EU VAT legislation, the European Commission brought Luxembourg to the Court of Justice of the European Union (CJEU) on 8 June 2016. In her opinion handed down on 6 October 2016, the advocate general Kokott confirmed the position of the European Commission and invited the Court to rule that Luxembourg’s cost-sharing VAT exemption does not comply with EU VAT Law.

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Court's decision

The Court confirms the three grievances against Luxembourg.

(i) Treatment of services contributed by the members to the group

In Luxembourg, the contribution of services/resources (e.g. supply of staff) by a member to a cost-sharing association without legal personality is regarded as being outside the scope of VAT.

This is the main point of the case since the majority of independent groups of persons ("IGP") set up in Luxembourg generally have no legal personality and do not have their own employees. These IGPs are used to pool support services such as HR, IT, finance services rendered by the members who have the qualified human resources. The fact that the refunds made to the members supplying their staff are not subject to VAT is a necessary condition for the cost-sharing exemption to work in practice.

On this specific point, the Court considered that Luxembourg went too far when transposing the EU Directive. The Court recalls that the IGP is a separate taxable person which provides services to its members. Therefore, any transaction between the group and one of its members must be treated as falling within the scope VAT. Consequently, any reimbursement received by a member from the IGP for services or goods acquired in its name but on behalf of the IGP should be subject to VAT.

(ii) Use of the services by the members

Under the Luxembourg VAT rules, the services provided by an independent group of persons to its members are exempt from VAT, provided that the members' taxed activities do not exceed 30% (or 45% under certain conditions) of their annual turnover.

The Court is of the opinion that the exemption can only apply if the services provided by an independent group of persons to its members are directly necessary for the exercise of their non-taxable or exempt activities. If the services provided by this IGP are also used for the purpose of the members' taxable activities, the portion of these services should be subject to VAT.

(iii) Deduction by the group's members of input VAT charged to the IGP by external providers

The Luxembourg VAT rules provide that the IGP's members are allowed to deduct the VAT charged to the group on their purchases of goods and services from third parties, up to their respective VAT recovery ratio.

The Court recalls that the IGP is an independent taxable person which is separate from its members. For this reason, the members are not entitled to deduct VAT in relation to goods and services acquired by the independent group of persons and not by those members directly.

Practical implications

It is important to first note that all the implications for the cost-sharing VAT exemption will only be known once the Court will release its decisions in the other three pending cases. Indeed, other critical questions on the scope of the exemption have been raised in *Commission v Germany* (C-616/15). In this case, the Court will have to answer the key question whether the cost-sharing VAT exemption should be limited to members carrying out activities in the public interest (and not to financial services providers or holding companies). The Court will also have to answer important questions related to cross-border independent groups of persons and interactions with transfer-pricing rules in the cases *DNB Banka* (C-326/15) and *Aviva* (C-605/15).

Since the Court has confirmed Luxembourg's infringement, the cost-sharing VAT exemption as it currently operates in Luxembourg will in principle have to be revised. Other EU Member States with similar implementing rules for the cost-sharing VAT exemption such as notably France and Belgium will likely have to review their VAT legislation too.

The impacts for cost-sharing arrangements in the financial sector are likely to be material. We do not know as at today when amendments may be reflected in our legislation and as from when they will become applicable (grandfathering period?). We however strongly recommend companies affected by this judgment to review their situation now if not yet done.

Furthermore, this decision will undoubtedly lead the authorities to consider again the need to implement VAT groups ("VAT unity" as referred to in Article 11 of the EU VAT Directive) in its national legislation.

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