Luxembourg to implement the VAT Group

20 April 2018

In brief

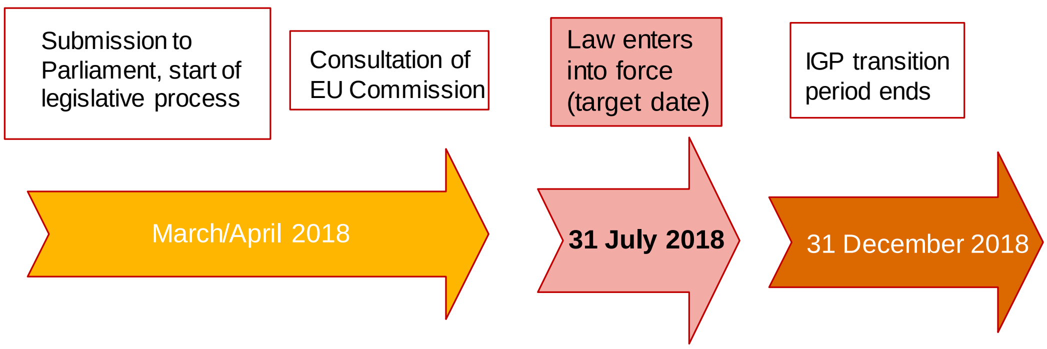
- Optional regime, but must be maintained at least 2 civil years;
- Only Luxembourg companies and local establishments of foreign companies;
- 3 cumulative conditions to join: members must be closely bound by financial, economic and organisational links (criteria further defined by law);
- Financial link must be certified by a “réviseur” or chartered accountant, annually;
- If conditions met, companies must join. Limited opt-out possibilities;
- Case-by-case analysis required as some members may lose when joining;
- We can help on the feasibility study, impact analysis, ongoing compliance/monitoring, and certification.

In detail

Expected timeline

In March 2018, the Luxembourg Finance Minister announced the introduction of the VAT Group as a quick reaction to the recent ECJ cases on cost-sharing arrangements (Independent Groups of Persons - IGPs). The ECJ rulings substantially narrowed the scope of the IGP VAT exemption and prohibited the financial sector to use it.

The draft law introducing the VAT grouping scheme was submitted to the Chamber of Deputies on 13 April 2018 and the mandatory consultation process with the EU VAT Committee is ran in parallel. The date of entry into force depends on the speed and outcome of the legislative process but it is acknowledged that the Finance Ministry intends to have it enacted by 31 July 2018.



From a tax perspective, this is possibly one of the most interesting announcements in this legislative year especially for the bankers, insurers and asset managers.

VAT Group within the EU

At EU level, the VAT Group is provided for in Article 11 of the EU VAT Directive[1], which is a "may provision" that Member States have the option to implement or not, as opposed to a "shall provision" which they are compelled to apply. Member States wishing to exercise that option must consult the VAT Committee and may adopt any measures needed to prevent tax evasion or avoidance arising from group registration. By opting to implement the VAT group, Luxembourg will join the list of 16 other EU countries who have implemented it.

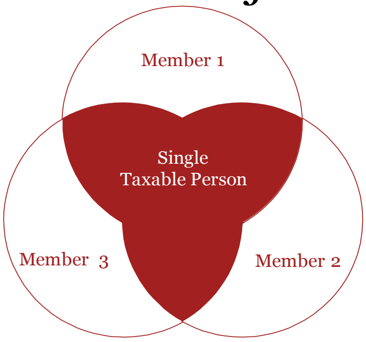
Article 11 provides makes plain that "each Member State may regard as a single taxable person any persons established in the territory of that Member State who, while legally independent, are closely bound to one another "*by financial, economic and organisational links*."

Why VAT Grouping?

The rationale of VAT Grouping was to provide Member States with a tool to combat abuse and fraud and at the same time simplify the administrative and compliance burden for both the tax authority and businesses, in the sense that typically only one consolidated VAT return for the VAT Group as a whole needs to be submitted. Being part of a VAT Group can also provide VAT cash flow efficiencies because the input VAT attributable to certain members of the group is credited against the output VAT of other members, which in turn reduces the amount of VAT refunds and related administration for the tax authorities.

Moreover, VAT Grouping is also an important element to limit the cascading of non-deductible VAT mainly for exempt and partially exempt businesses. This is because supplies between group members are disregarded for VAT. Therefore, no VAT applies on goods or services supplied between VAT group members.

The Luxembourg VAT Grouping regime



In the following pages, we set out a summary of the key features of the initial draft VAT group law.

[1] Council Directive 2006/112/EC of 28 November 2006 on the common system of value added tax

Conditions for joining a VAT Group

The following conditions will have to be fulfilled to apply for VAT Grouping:

- Members must be established in Luxembourg or have a fixed establishment in Luxembourg. Therefore, establishments located abroad are ineligible to join.
- Additionally, the three following links need to exist simultaneously: financial, economic and organisational.

Financial Link	Economic Link	Organisational Link
Relationship of control : • Direct or Indirect ; • Actual or Legal (de facto or de iuris)	Activities • Similar • Complementary • Influential • Joint or Economic Purpose • For the benefit of (an)other(s)	Management: • The same management • Mutual Consent • Controlled by one and the same person

The **financial link** is defined in the draft text as the direct or indirect control by reference to the Commercial Companies law and consolidated accounts. Financial links could therefore be demonstrated by either i) holding the majority of voting rights (over 50%) or ii) by having the power to appoint or recall the majority of the members of the board (management or supervision organ) while also being a shareholder or iii) by owning the majority of the voting rights by virtue of a shareholders agreement. The existence of the required financial links will need to be certified by an independent auditor (“Réviseur d’entreprises agréé”) or a chartered accountant upon application for joining the VAT group and should be renewed each year.

The **economic link** is activity based. In this regard, the draft text refers to three possible forms of cooperation: i) either all members have the same core business, or ii) their activities are complementary/interdependent or iii) the activities benefit the other members.

The **organisational link** is one of co-ordination between the decision makers. The entities must be directly or indirectly under a shared, or at least partially shared, management structure.

One person can only belong to one VAT group. Once members have opted to join the VAT group, they must operate the VAT group during at least two civil years.

All related persons that fulfil the conditions must enter the VAT group. There is a possibility to opt out under certain conditions provided that it does not result in VAT savings. Persons engaged in activities that, by their nature, are not specific to the activity of the group must be excluded if their integration into the VAT group results in a distortion of competition.

VAT group representative and compliance matters

VAT group representative

The group has one representative member, who is the controlling entity or, by default, the entity with the highest turnover. The VAT group can opt for another representative member if it can demonstrate that that member is de facto in a better position to represent the group and has unconditional access to all relevant data and information regarding the VAT group. The representative member has the main compliance responsibility but all members are jointly and severally liable for VAT debts.

VAT group compliance matters

VAT group members are jointly liable for all VAT obligations arising during the lifetime of the VAT group or the period during which they belong to the VAT group. The VAT group is liable for any VAT adjustment regarding past transactions of its members and each member remains liable for VAT adjustments regarding transactions of the VAT group after leaving the group. The representative member must notify the VAT authorities within 15 days when a new entity becomes eligible to enter the VAT group or when a group member is no longer eligible to remain in the group.

For group members no longer eligible to remain in the group their removal from the group is effective as from the date upon which they no longer satisfy the relevant requirements. Ex-VAT group members should keep their auxiliary VAT number if they continue a taxable activity.

The VAT group will have one VAT number and each member will have auxiliary VAT numbers related to transactions with their own contracting parties. VAT invoices (incoming and outgoing), where applicable should be issued under the name, address and auxiliary VAT number of the relevant group member. Transactions between group members are treated as transactions between the same legal entity and therefore out of scope for VAT purposes.

European Sales Lists (ESL) are to be filed by the group and should be in the name and under the auxiliary VAT number of each group member. Filing frequency for ESLs is based on the turnover of the VAT group. The VAT group must declare in its annual VAT return the detail and amount for all intra-VAT group transactions.

The VAT group will need to apply the normal rules on input VAT deduction. Input VAT deduction depends on actual use of goods and services by the VAT Group towards third parties outside of the VAT group. If used for transactions with right to deduct, VAT is deductible. If used for transactions without right to deduct, VAT is not deductible. For costs that cannot be directly attributed to either activity, a special VAT recovery ratio could be computed and if this is not possible, a general pro rata split will be computed and applied.

Is the Luxembourg VAT Group a separate taxable person? The impact of the "Skandia case"

The Luxembourg VAT Group is expected to be treated as a separate taxable person in the context of cross-border supplies where either the head office or a branch is a member of a local VAT group. The same applies when a Luxembourg head office or branch provides services to an establishment in another EU Member State, also a member of a VAT Group. This is in line with the Skandia case[2] in which the CJEU asserted that once a branch joins a VAT group, all supplies to it must be treated as being supplied to the VAT group as opposed to being made to the single taxable person who is the *de facto* recipient of the supplies. Consequently, the Luxembourg VAT group would have to bear additional VAT cost by self-accounting for any Luxembourg VAT due (using the reverse charge mechanism) on all intercompany, including branch-to-branch or head-office to branch, taxable services provided into the Luxembourg VAT group. Given the value of intercompany and intra-company transactions, Luxembourg businesses will need to consider whether using the VAT group will be beneficial for them considering their very own situation.

Next steps

VAT Grouping will be a new reality within the Luxembourg tax system in the near future. It is an important development and does not only address the needs of partial exempt businesses like banks, insurance companies, holding companies, asset managers, investment funds, real estate and private equity vehicles. It can also be used by industrial and services businesses with full VAT recovery; in this last case it is merely a way to optimise VAT cash flows.

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[2] Skandia America Corporation (C-7/13)

The law will soon be applicable and the implementation of the first VAT groups is expected in 2018. Opportunities and advantages aside, VAT grouping also comes with operational challenges. Therefore, it requires a careful prior analysis; business case needs to be ascertained.

We have set up a dedicated group advising clients on the implementation of the VAT Group. They may help from the early stages of the feasibility study and impact assessment to the application for VAT grouping registration and related compliance. We are happy to discuss this with you or provide further clarity.

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