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German Tax and Legal News

Partnership can be controlled party in a VAT group. German VAT group in line with the EU provisions? Nontaxable persons cannot be the controlling entity of a VAT group

The Federal Tax Court has ruled that partnerships may be a controlled company in a VAT group in certain cases. Nontaxable persons may not participate in such a group as controlling entity.

Germany's Federal Tax Court (BFH) issued five decisions on 2 and 3 December 2015, which were published on 28 January 2016, in response to a Court of Justice of the European Union (CJEU) decision on the German VAT group rules. The BFH cases address several aspects of the rules, and explain why the German concept of a VAT group permits the inclusion of partnerships and otherwise is in line with the relevant EU provisions.

The CJEU held on 16 July 2015, in the joined cases of Larentia and Minerva and Marenave Schiffahrt (C-108/14 and C-109/14), that Germany's exclusion of a partnership from qualification as a controlled party in a VAT group and the general requirement of a "subordination" system within the group (i.e. that a control relationship exists between the controlling company and the controlled companies) is not in line with the EU VAT directive. According to the CJEU, access to a VAT grouping regime may not be limited to entities with legal personality, unless such a restriction is appropriate and necessary to combat tax avoidance or tax evasion.

In its December 2015 decisions, the BFH concluded that Germany's current domestic law does permit a partnership to be included in a VAT group, and used the possibility acknowledged by the CJEU that the conditions for forming a VAT group under EU law may be restricted in appropriate circumstances.

The BFH's most significant holdings in the relevant cases are as follows:

1. German law allows partnership to be a controlled company in a German VAT group

The German VAT group rules provide that (only) "legal entities" can be controlled companies within a VAT group. By way of teleological interpretation that the term "legal entity" also includes partnerships the BFH examined the purpose of the German restriction and determined that it relates to financial integration within the group. Accordingly, the BFH held that the term "legal entity" includes partnerships, provided the conditions for financial integration (majority of voting rights) can be fulfilled.

However, since the principle of unanimity generally applies for partnerships, the conditions for financial integration likely will be fulfilled only in exceptional cases. For example, the requirements would be met within a GmbH & Co. KG (i.e. a limited commercial partnership in which the general partner is a limited liability company) when 100% of the limited partnership interests in the KG are owned by the same limited partner, and the limited partner simultaneously is the owner of more than 50% of the GmbH (general partner).

2. Subordination system permissible under EU law

In a separate opinion, the BFH clarified that the German requirement of a subordination system within a VAT group is in line with the EU reservation for specific matters in which discretion is granted to the EU member states. Thus, VAT grouping is not available for sister companies.

3. Nontaxable persons cannot be the controlling entity of a VAT group

Another decision issued by the BFH clarifies that the German exclusion of nontaxable persons from being the controlling entity in a VAT group is in line with EU law, because the relevant EU provisions do not exclude nontaxable persons, but also do not require such persons to be covered as controlling entity by VAT grouping regulations.

Comments

It is important to note that a German VAT group is formed automatically if all of the relevant

requirements are met--no application procedure is required. Thus, partnerships fulfilling the requirements clarified by the BFH already are considered part of a VAT group. In cases where previous VAT periods still are open for reassessment, company groups may use the BFH's decisions to include qualifying partnerships in their VAT groups.

Company groups also should be aware of the risks of automatic VAT grouping, which could lead to a redetermination of supplies within the group.

It is unclear how the German tax authorities will react to the BFH decisions; potentially they will release guidance indicating that it will not apply the rules for previous years.

VAT groups and company groups should be reviewed with regard to the new conditions for grouping, and potentially restructured to ensure or to prevent VAT grouping in the future.

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