

EY TAX Alert

Luxembourg

The CJEU judgement on EU VAT cost sharing exemption (Luxembourg vs Commission)

Executive summary

On Thursday 4 May 2017, the Court of Justice of the European Union (CJEU) released its long awaited judgement in Case C-274/15 Luxembourg vs Commission, concerning the operation of the Luxembourg Independent Group of Persons (IGP).

Across the EU, Member States have interpreted and implemented the IGP rules differently, leading to complexities, particularly as regards (i) to cross-border services flows, (ii) to the recognition of deduction right of the IGP members as well as (iii) to conditions applicable in order to become an IGP member.

Back in October 2016, the Advocate General Kokott (the AG), in its opinion in the case at hand agreed with the initial findings of the EU Commission and opined that certain features of the Luxembourg IGP rules are not in line with the EU VAT Directive.

Sadly, the CJEU in its yesterday's judgement followed the opinion of the AG stating that a number of features of the

Luxembourg IGP model is in contradiction with the broadly defined EU VAT rules on the subject matter.

Implications of this judgement will go far beyond Luxembourg financial sector and may result in a wide spread necessity of remodeling existing structures as well as a quest for solutions allowing reasonable management of VAT aspect at a "group level".

If we add on top of that three other pending cases Federal Republic of Germany (C-616/15), DNB Banka (C-326/15) and Aviva (C-605/15), awaiting judgements on the subject matter (the opinions of the AG in the two last cases also decrease the usefulness of an IGP, i.e. in deciding namely on the non-applicability of an IGP in the financial sector and on the automatic failure of the exact reimbursement test where a 'mark-up' is required for transfer pricing purposes, etc.) the necessity of coming up with a "plan B" proves inevitable.

Background

The Commission drew the attention of the Grand Duchy of Luxembourg to the fact that the VAT regime applicable to the IGP as defined in particular, in article 44, §1, y) of the Luxembourg VAT law and in articles 1 to 4 of the Grand-Ducal regulation of 21 January 2004 on the services rendered by an IGP to its members, is not compatible with several provisions of directive 2006/112/EC (VAT Directive), namely bringing an action to the CJEU on the following three points:

- ▶ The services supplied by IGPs for the benefit of their members are exempted from VAT, including where those services are used for the purposes of the taxed transactions of those members where the annual turnover in relation to those taxed transactions does not exceed 30%, or even 45% in certain cases, of their total annual turnover
- ▶ The members of an IGP who carry out taxable activities up to a maximum of 30% (or 45%) of their total annual turnover may deduct their fair share of VAT invoiced to the IGP in respect of the goods and services supplied to it from the VAT for which they themselves are liable
- ▶ Finally, where a member of an IGP acquires goods and services from third parties in his own name, but on behalf of the IGP, the national legislation excluded from the scope of VAT the transaction consisting, for that member, in allocating to the IGP the expenses thus incurred

The Judgement

Services rendered by the IGP to its members

With reference to the first ground, the Court found this particular rule implemented by Luxembourg as not compatible with the VAT Directive. Interestingly however, the Court disregarded the level of the taxable activity threshold of 30% or 45 %.

The Court simply found it irrelevant and noted that the exemption applies only to services which are rendered by the IGP to its members for the purpose of exempt activities or activities in relation to which they are not taxable persons. Consequently, any services rendered by an IGP for the purpose of taxable activities performed by its members should be subject to VAT.

On that basis, it could be concluded that an IGP could render both taxable and exempt services, to its members, and consequently should be able to deduct part of the input VAT it supported and which could be directly linked to its taxable activity (note that the Luxembourg IGP is not allowed to deduct any input VAT under existing regime).

Deduction by the members of the input VAT incurred by the IGP

On second ground, the Court found Luxembourg provisions as being contrary to the EU legislation. Indeed, the Court repeats that it is not a member of an IGP who is entitled to deduct VAT on the goods and services acquired by the IGP but the IGP itself which could potentially have the right to claim deduction of that input VAT.

Treatment of services/costs allocated by the members to the IGP

Finally, the third ground for complaint concerning a situation in which the member of an IGP acquires goods or services in its name but on behalf of the IGP. The Court stressed out to the fact that IGP is a taxable person in its own right, separate from its members. Consequently, the transactions between a member of an IGP and an IGP which acts independently are to be regarded as transactions between two independent taxable persons which fall within the VAT scope.

Implications

Long criticized by the Commission for its liberal and favorable conditions, the Luxembourg IGP model will need to be reshaped and adjusted to align with the Court's decision. It is yet to be decided how the Luxembourg State tackles the practicalities around this aspect of crucial importance for the whole Luxembourg financial sector, including its future attractiveness for certain players within the scope of "Brexit".

Certainly, the applicability of the "grandfathering rule" and acceleration of VAT grouping should be now the main topics in the weeks to come (a Parliamentary Question has been addressed to the Ministry of Finance on this topic already the day after the judgement).

From a Luxembourg perspective, where the IGPs are used extensively in the broadly defined financial sector, the taxpayers should consider the impact of any potential remodeling / withdrawal from the IGP as well as any alternative options that may be available. This is likely to include i.a. discussions around the possibility of prompt introduction of VAT grouping into the national law or the use of other systems that would allow local players to share resources without additional VAT costs, such as i.a. Global Employment Contracts.

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