VAT consolidation in Europe

Disharmonious harm

Recently, VAT grouping has again been on the political agenda of a number of EU Member States. Belgium will introduce it on 1 April 2007 and Spain will do so on 1 January 2008. Luxembourg is also considering introducing it.

VAT grouping means that two or more taxable persons that are legally independent are treated as a single taxable person for VAT purposes. This enables undertakings to structure their businesses more efficiently, reduce compliance costs and avoid the burden of VAT in a number of situations.

Concept of VAT grouping

The basic concept behind VAT grouping and the general conditions for implementing it are set down in article 11 of Council Directive 2006/112/EC of 28 November 2006 on the common system of value added tax (former article 4(4) of the Sixth Directive). This allows EU Member States to treat independent legal persons as a single taxable person if they are closely bound by financial, economic and organisational links.

One of the reasons why many Member States have VAT grouping is to make their country more attractive to foreign direct investors and to reduce the cost of doing business. It is also a method to fight VAT fraud.

When a group of companies form a VAT group, they are one taxable person from a VAT viewpoint. This means that, for VAT purposes, all supplies of goods and services to or by the members of the group are deemed to be made to or by the VAT group. Between members of the group, no VATable supplies occur, even though, from a legal point of view, still transactions take place. This means that the members of a VAT group do not have to charge VAT on intra-group transactions. Furthermore, the VAT group will normally file one, consolidated VAT return.

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Advantages of VAT grouping

Forming a VAT group has a number of consequences from a business perspective. Firstly, in some cases, companies can avoid the burden of VAT when charging staff costs on to other members. This might be the case where a shared service centre has to charge its costs on to a group company that has no right to deduct VAT. Without a VAT group, the services of the shared service centre are subject to VAT, which is a cost to the recipient. If the two companies form a VAT group, there is no VAT on the services that the shared service centre charges to the group company.

Secondly, VAT grouping eliminates the risk of intra-group transactions being subject to incorrect VAT treatment, as these transactions fall outside the scope of VAT.

Thirdly, VAT grouping could have a positive impact on companies' cash flows as the VAT debit/credit positions of all the members of the group are netted within one and the same VAT return.

Fourthly, VAT grouping has an impact on compliance costs.

On the one hand, these costs will reduce (one VAT return, no intercompany invoicing for VAT purposes). On the other hand, some minor changes could be required to the ERP system to deal with the intra-group transactions.

VAT grouping has also a number of advantages for the tax authorities. Firstly, in most countries, members of the VAT group are jointly liable for VAT debts of the VAT group. This increases the guarantees for tax authorities that the VAT debt is effectively paid and if not it can be collected. Secondly, tax authorities are able to inspect a group more efficiently.

Best practices

Even though the regulatory framework for VAT grouping is EU-based, there are many differences between Member States when it comes to implementing the rules in practice. Here, we discuss only the most important practices.

a) Eligibility rules

A first difference among Member States is whether companies are obliged to form a VAT group or can choose whether or not to do so. Needless to say, businesses prefer to have a choice of forming a VAT group. And most Member States have gone for this option. Only Austria, Estonia, Germany and the Netherlands in some cases oblige companies to form a VAT group.

A second difference is the taxpayer status of the members of the VAT group. Some Member States only allow taxable persons with a full right to deduct VAT to become members of a VAT group. Others also allow partial exempt or partial taxable persons to join and yet others allow non-taxable persons be included.

It is worth noting that most Member States allow all three categories to form part of a VAT group. However Austria, Cyprus, Ireland and Italy have other rules. As things presently stand, the draft legislation in Belgium will exclude non-taxable persons, such as a passive holding company to be a member of a VAT group.

A last crucial difference relates to proving the financial, economic and organisational links among the members. Some Member States define the controlling company as a company that in practice can con-

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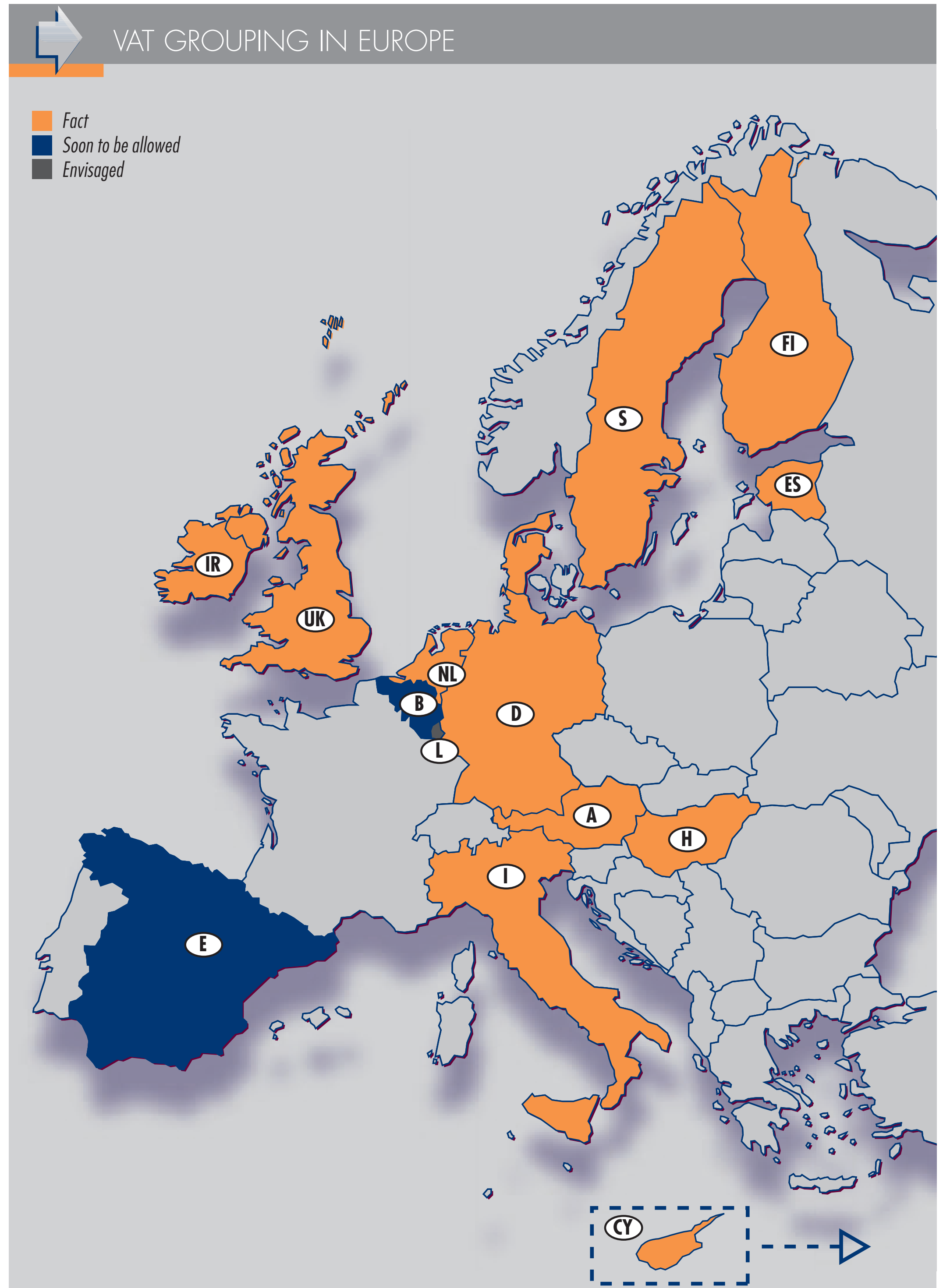
trol the other members of the group. Other Member States refine these criteria with minimum percentages of voting rights, e.g. the power to appoint 50% or more of the directors.

b) Administrative requirements

Here, the most marked differences concern VAT numbers and VAT returns. A number of Member States have a special VAT return for VAT groups and cancel the VAT numbers of the individual members. Other Member States keep both types of numbers. This second solution is preferred because, if a business's individual VAT number remains active, it does not have to make major changes to its ERP system. Members can also more easily leave the VAT group and resume using their old VAT numbers. Plus, provided the individual members are still active (in some way), this will not create issues with the European VIES system. International customers and suppliers can still verify and rely on the VAT numbers of the individual members.
Furthermore, there is no need to change purchase processes, as the number of members can still be used when ordering goods with suppliers.

c) Input VAT recovery

Finally, there are differences as to how the right to deduct input VAT is calculated. Most Member States set the right to deduct VAT at a group level, except for Estonia, Germany, Hungary and Italy, which calculate the right to deduct VAT at the level of each entity.



Conclusion

Nearly half the Member States of the European Union have introduced VAT grouping into their national legislation. When a VAT group is formed, businesses should clearly scrutinise their local legislation and beware that the rules on VAT grouping in other countries are not necessarily the same as in the home country, even if VAT grouping is based on an EU directive. As usual, VAT has been EU-harmonised, but disharmoniously.

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