

European Union: CJEU rules on Luxembourg's implementation of IGP exemption

On 4 May 2017, the Court of Justice of the European Union (CJEU) issued the first of four decisions involving member states' implementation of the "independent group of persons" (IGP) exemption in the EU VAT directive. In this case, the CJEU held that Luxembourg's rules for determining the application of the exemption are too broad and, therefore, are not in line with the directive. The CJEU upheld the infringement proceedings brought by the European Commission against Luxembourg in 2011, and followed the 2016 opinion of Advocate General (AG) Kokott.

Background

Article 132(1)(f) of the VAT directive directs EU member states to grant a VAT exemption when two or more persons or organizations that carry out VAT-exempt activities (*e.g.* banks, insurance companies, hospitals) and/or nonbusiness activities (*e.g.* not-for-profit organizations, public bodies) join together to form an independent cost-sharing group to provide services to group members. To qualify for the IGP exemption:

- The members' activities must be exempt from VAT or be outside the scope of VAT;
- The shared services must be directly necessary for the members' activities; and
- The group must claim reimbursement of each member's share of the joint expenses.

The IGP exemption allows qualifying groups to share resources; in effect, VAT supplies made to group members at cost for the purpose of their own exempt or nontaxable activities are exempt from VAT. Without the IGP exemption, an external structure holding the centralized resources would have to charge VAT on its supplies of the resources to the group members, which, given their VAT-exempt or nonbusiness activities, could result in a final irrecoverable cost for the members.

The IGP exemption has been widely used by taxable persons operating in the financial sector and by not-for-profit organizations in several EU member states, but it also has been the subject of controversy.

The lack of specific details in the directive regarding the conditions for the application of the exemption has resulted in various EU member states imposing different conditions to qualify for the exemption in their implementation of the rules in their domestic law. The European Commission highlighted under-use of the IGP exemption in member states that have overly restrictive IGP regimes and those that have provided insufficient guidance for the application of the exemption in a document issued in 2010. Therefore, it was somewhat of a surprise when the commission challenged Luxembourg's IGP regime in 2011.

Luxembourg law and commission's challenge

Under Luxembourg's VAT law and administrative practice:

- Services supplied by an IGP for the benefit of its members are exempt from VAT, provided the taxed activities of the group member do not exceed 30% (45% in certain cases) of annual turnover, even if the services are used for the group members' VAT-taxable transactions. (This rule was introduced because many taxable persons in the financial and not-for-profit sectors undertake some activities that are subject to VAT).
- IGP group members that carry out taxable transactions may deduct the VAT charged to the group on purchases of goods and supplies of services from the VAT to which they are liable.
- Goods and services acquired in an IGP group member's own name, but on behalf of the IGP, are outside the scope of VAT and, therefore, are nontaxable.

The commission took the position that Luxembourg's rules on IGPs were incompatible with the VAT directive and, in 2011, it officially asked Luxembourg to revise the rules. Luxembourg did not amend the rules, so the commission referred the case to the CJEU on 8 June 2015. In an opinion issued on 6 October 2016, AG Kokott recommended that the CJEU conclude that Luxembourg has infringed the VAT directive by:

- Exempting services supplied by autonomous groups to their members in cases where the services are not directly necessary for the exempt activities of the members;
- Allowing an input tax deduction to members where supplies are made to the group; and

- Adopting an administrative practice that ignores for VAT purposes purchases that are made by a group member in its own name, but for the account of the group.

Decision of the CJEU

The CJEU followed the opinion of AG Kokott and found the three features of the Luxembourg IGP regime challenged by the commission were incompatible with the VAT directive:

- Based on the clear wording in the VAT directive, only services supplied by an IGP to its members that are directly necessary for the exercise of their exempt (or nonbusiness) activities qualify for the IGP exemption. Services related to VAT-taxable activities carried out by the group members should be subject to VAT.
- A group member may not recover the VAT on costs incurred by the IGP because the IGP – not the member – is the beneficiary of the supply. The IGP must be an independent taxable person to make supplies of services to its members, and VAT incurred on supplies rendered for the benefit of the IGP, therefore, cannot be deductible by its members.
- The Luxembourg IGP regime allows members of an IGP to purchase services in their own name but on behalf of the IGP, and then have a subsequent transfer of those services to the IGP be outside the scope of VAT. The CJEU stated that services acquired in the name of the members may not be transferred to the IGP without VAT being applied.

Comments

The court's ruling is a substantial narrowing of the scope of the application of the IGP exemption and likely will make the use of the exemption more cumbersome in some cases, or possibly unworkable. It is difficult to see how the decision could satisfy the European Commission's previously expressed wishes that the IGP exemption be more broadly used. For its part, Luxembourg will need to revise its rules so they are in line with the CJEU decision.

Decisions in the three other cases regarding the IGP exemption that are pending before the CJEU should be issued within the next few months.

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