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The Unsettled Dispute over the Cross-border Application of the Cost-sharing Exemption: Some Reflections on the CJEU's Judgment in C-77/19 *Kaplan International Colleges UK* (Part II)

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Introduction

The first part of [my reflections on case C-77/19 *Kaplan International Colleges UK*](#) (further referred to as *Kaplan*) concerned the relationship between membership in a VAT group on the one hand and a cost-sharing group on the other. In this article, I will comment on the questions referred to the CJEU, which the Court considered unnecessary to answer, namely on the geographical scope of the exemption for independent groups of persons (IGPs) and its impact on the assessment of the lack of distortion of competition condition.

The problem

An exemption for supplies of services by IGPs to its members can apply when a number of conditions are fulfilled. Among these conditions, Article 132(1)(f) of the VAT Directive[1] does not mention that either the group or the members should be established only in one Member State's territory. Unlike in the case of Article 11 on VAT grouping[2], the wording of Article 132(1)(f) does not provide any limitation as to the place of establishment of the persons forming an IGP.

However, many practical obstacles in the application of the exemption in cross-border scenarios have caused headaches to tax administrations and businesses. The concerns regard the assessment of the conditions for the application of the exemption, out of which the requirement that the exemption is not likely to cause distortion of competition is particularly difficult. The VAT Committee has analyzed these issues in several working papers.[3] In a cross-border scenario, tax authorities of a Member State, in which the supply takes place, have to verify, for example, whether the recipients of services are indeed members of an IGP, whether the services are directly necessary for the exercise of exempt or out-of-scope activities of the members, and whether they are supplied at cost, even if neither the members nor the IGP are established within the territory of the Member State. In other words, to determine whether the exemption is applicable, tax authorities would rely on information that could be difficult to verify, especially in the case of IGPs established outside the EU.

Furthermore, the cost-sharing exemption is currently applied on a non-uniform basis, with the Member States having in their national legislations conditions exceeding those listed in Article 132(1)(f) or interpreting those conditions differently. The lack of common understanding of the

condition on non-distortion of competition and how this condition should be assessed causes another obstacle for a cross-border application of the cost-sharing exemption. Even though the CJEU has shed some light on this point in *Taksatorringen*[4] and *Commission v Germany*[5], it remains unclear, for example, whether the assessment should take into consideration the characteristics of particular market conditions.[6]

These constraints have caused doubts as to whether Article 132(1)(f) on its proper interpretation should apply cross-border and, if that is the case, how the fulfilment of the other conditions should be assessed.

***Kaplan*, the CJEU and the geographical scope of Article 132(1)(f)**

Kaplan concerned an IGP established in Hong Kong that supplied services to its members established in the United Kingdom. The first question referred to in the case was whether the cost-sharing exemption could apply in such a cross-border scenario. The second question was conditioned upon a positive answer to the first question and concerned the assessment of the distortion of competition. It included seven particular sub-questions on factors relevant to the determination of the likelihood of the distortion of competition. However, the CJEU has elegantly avoided answering both those questions by choosing first to answer the third and fourth questions referred to in the case and concluding that the cost-sharing exemption did not apply to a group whose members formed a VAT group in circumstances where not all the VAT group members were also members of the IGP.

Kaplan is not the first case in which the CJEU had a chance to determine whether Article 132(1)(f) applies cross-border. A question on the geographical scope of the provision was referred by national courts both in *DNB Banka*[7] and *Aviva*[8]. *DNB Banka* regarded a credit institution established in Latvia, being part of the DNB group and receiving services from related companies established in Denmark and Norway. The questions referred included an inquiry as to whether it is possible to form an independent group of persons and apply for the exemption when the members of the group are established in different Member States, in which Article 132(1)(f) has been transposed in another, non-compatible way. *Aviva* concerned a group consisting of companies providing insurance services, saving plans and fund management. The group was planning to set up shared-service centres in various Member States and for a European Economic Interest Group (EEIG). Part of the questions referred to in the case regarded, similarly to the questions referred in *Kaplan*, the consequences of the group members' belonging to different national jurisdictions for the assessment of the absence of distortion of competition.

Like in *Kaplan*, the CJEU did not consider it necessary to answer these questions since there were other grounds to preclude the exemption application in the given circumstances. In both *DNB Banka* and *Aviva*, that ground was that the members of the IGPs operated within the insurance and financial sector and thus did not engage in activities exempt for public interest within the meaning of Article 132 of the VAT Directive. In the case of the two latter cases, the controversy of that conclusion is exacerbated by the fact that the referring courts have not asked at all a question to that end.

In all three above-mentioned cases, the opinions were delivered by AG Kokott, who has consistently held that the cost-sharing exemption cannot be applied to IGPs operating cross-border. According to the AG, even though the provision's wording does not include an explicit limitation to groups operating only within a single Member State, such limitation follows from the scheme

and the history of the exemptions in the VAT Directive. The heading of Article 13 of the Sixth Directive^[9], in which the exemption was earlier provided, was ‘exemptions within the territory of the country’. As the current VAT Directive does not change the substantive content of the provision laying down the exemption, the same limitation should, according to the AG, regard Article 132(1)(f). What is more, the current Title IX of the VAT Directive contains chapters specifically devoted to cross-border exemptions, especially cross-border transport services in Chapter 7. Article 132(1)(f) does not belong to those chapters.

These arguments have certain flaws.^[10] First of all, they derive from a currently non-existent heading in the Directive, which necessarily questions the reasonability of the legislator who decided not to include the same heading in the current VAT Directive. Furthermore, even where the lack of insertion of the heading could be attributed to an unintended omission, it would not prevent Article 132(1)(f) from applying cross-border, in the same way as it does not prevent any other exemption belonging to that category from a cross-border application. Undoubtedly, exemption, e.g. for insurance, applies irrespective of whether the supplier is established in the same state as the recipient or both parties to a transaction are in different states. The place of supply rules determine in which state VAT is due and the laws of which state are applicable. These rules should ensure that the Member States do not encroach upon each other’s taxing jurisdictions.

I am also not convinced by another argument, namely that of the inconsistency of interpretation allowing for cross-border cost-sharing exemption under Article 11 of the VAT Directive. The latter envisages a possibility to form a VAT group by persons established within the same Member State. An IGP cannot be compared in that context to a VAT group. Article 132(1)(f) does not provide a basis for forming any particular structure or entity, such as a new taxable person who could operate cross-border. The focus of Article 132(1)(f) is on a transaction that must be exempt when a particular kind of relationship between the supplier and the recipient exists, and a number of conditions are fulfilled. Article 11 and Article 132(1)(f), despite having many similarities, including sharing the underlying rationale, are nevertheless separate provisions with their own conditions for application and distinct consequences. If both were to be interpreted in the same way and have the same scope, one of the provisions would be redundant.

According to the AG, the geographical restriction on the freedom to provide services does not infringe EU provisions on fundamental freedoms. The restriction is justified by the need to preserve the allocation of the power to impose taxes between the Member States and the need to guarantee the effectiveness of fiscal supervision. What is more, such restrictive interpretation is necessary to make it possible for the Member States to ensure that the exemption is applied correctly and straightforwardly and prevent evasion, avoidance, or abuse, which is an obligation imposed on the Member States by Article 131 of the VAT Directive.

On the other hand, the CJEU has consistently held that the substantive definition of the exemptions cannot be affected by the need to prevent any possible evasion, avoidance or abuse. That seems to be equally true in relation to the geographical scope of Article 132(1)(f). Even if the limitation does not infringe the provisions of the Treaty on the fundamental freedoms, it does infringe the clear wording of Article 132(1)(f).

There are no doubts that the cross-border application of the exemption can be burdensome in practice. However, the practical considerations should not outweigh a proper textual, purposive, and contextual interpretation of Article 132(1)(f). These elements, in my opinion, can only lead to a conclusion that limitation of cost-sharing exemption to groups operating within one state is

incompatible with Article 132(1)(f). The exemption is meant to mitigate the negative consequences of non-deductibility of input VAT for providers of exempt services. It is supposed to increase the neutrality of VAT for businesses and offset the competitive disadvantage faced by small undertakings. I believe that that very purpose of Article 132(1)(f) provides valid arguments for a broad interpretation of the provision also in a geographical sense. Otherwise, instead of enhancing fair competition, the exemption would create further distortions of competition between IGPs operating within one jurisdiction and those operating cross-border.

It seems that the majority of the issues is not a consequence of cross-border IGPs, but rather a lack of clarity as to the factors relevant for assessment of the conditions for application of the exemption, lack of uniformity in its implementation and application among the Member States, and ineffective administrative cooperation between national tax administrations. Thus, a key to solving those issues should lie in addressing these specific obstacles.[11]

Conclusion

In *Kaplan*, the CJEU had a chance to reach another milestone as to the interpretation of Article 132(1)(f) by ruling on the geographical scope of application of the provision. Once again, however, it chose to remain silent on that issue. In this article, I argued that although a geographical limitation of the scope of application of the exemption for the IGPs could be motivated by practical obstacles, it would constitute interpretation *contra legem*, against the wording of Article 132(1)(f). Arguably, the CJEU has already ruled against the wording of the provision in *DNB Banka, Aviva*, and *Commission v Germany*[12]. When contrasted with those rulings, perhaps the silence of the CJEU in *Kaplan* should be a relief.

Indeed, one could have the impression that the CJEU is not convinced by the AG's argumentation on the matter. The geographical scope was subject to the first and the second questions referred to in the case. Nevertheless, the CJEU has decided to answer the third and fourth question first. If the CJEU were convinced that the cost-sharing exemption did not apply cross-border, it would have sufficed to answer the first and second questions and to leave unanswered the two other questions. Perhaps the CJEU needs more time to prepare a meaningful interpretation should the question on the geographical scope of cost-sharing exemption be referred to it again, which seems to be just a matter of time. Hopefully, the next referral to the CJEU will not have too many other questions (or circumstances rendering the exemption inapplicable), which the Court would be able to cherry-pick from.

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

[2] It follows from the recent judgment of the CJEU in C-812/19, *Danske Bank*, EU:C:2021:196, that this limitation also means that overseas establishments cannot be included in a VAT group.

[3] See, in particular, Working Papers no 856 and 883.

[4] C-8/01, *Taksatorringen*, EU:C:2003:621.

[5] C-616/15, *Commission v Germany*, EU:C:2017:721.

[6] See VAT Committee, Working Paper no 856, section 3.6.

[7] C-326/15, *DNB Banka*, EU:C:2017:719.

[8] C-605/15, *Aviva*, EU:C:2017:718.

[9] Sixth Council Directive 77/388/EEC of 17 May 1977 on the harmonization of the laws of the Member States relating to turnover taxes – Common system of value added tax: uniform basis of assessment.

[10] As I previously argued, in M. Papis-Almansa, *Cost-sharing Exemption in the Case Law of the CJEU*, in K. Egholm Elgaard et. al (eds.), *VAT Grouping and Cost-Sharing – a Critical and Constructive Perspective* (Ex Tuto Publishing A/S, 2020), pp. 235-263.

[11] See VAT Committee, Working Paper no 883, section 3.7.3.

[12] C-616/15, *Commission v Germany*, EU:C:2017:721.

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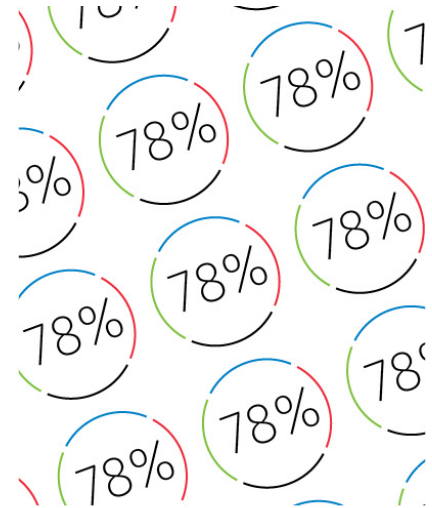
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