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Transposition of the VAT Group Regime : A systemic change

VAT GROUP

The VAT Group regime provided for in Article 11 of the VAT Directive is expected to be proposed for transposition into French law as part of the draft Finance Act for 2021, although this is still subject to the various uncertainties relating to the parliamentary discussions after the summer. This regime adopted by most EU Member States allows different legal entities established in the same Member State to be considered as a "single taxable person" provided that they are closely linked to each other financially, economically and in terms of organization. This regime makes it possible to ignore all supplies of goods and services between the Group entities and to report only transactions with external third parties. Therefore, it enables a single VAT return to be filed, consolidating all of these transactions.

The implementation of the VAT Group regime in France may be speeded up by the questioning of another regime: the exemption of services rendered by groups of exempt persons to their members (Article 132.1.f of the VAT Directive). Commonly used in the financial sector, this exemption had been judged inapplicable to the banking and insurance sectors by the European Court of Justice. However, while the introduction of the VAT Group regime is a welcome remedy to this situation, it pursues a more general objective and applies to all economic sectors, without exception. It is unquestionably an instrument of modernization and strengthens France's attractiveness.

The project provides for the effective implementation of VAT Group at the earliest on January 1, 2022. The new regime will not affect the calculation of the payroll tax, which will remain unchanged.

An optional regime

The constitution of VAT Group is optional and based on an election that must be filed by the Group's representative (who is freely chosen) with the agreement of the members of the perimeter. The election must be filed before October 31st of the calendar year prior to the effective implementation of the Group. The duration is necessarily 5 calendar years, but some events may allow a member to join a Group during its lifetime (acquisition, creation).

The choice of the Group members is freely determined provided, however, that the members are established in France and meet the criteria of financial, economic and organizational links that must connect them. These conditions must be cumulatively met and respected not only during the year of the election but also throughout the Group's existence:

- Financial link assumes that 50% or more of the capital or voting rights of the entities in the future Group are controlled by the same taxable person.
Certain exceptions will allow non-capitalized organizations to join the Group's regime

(in particular mutual banks or mutual insurance companies, pension and provident institutions, entities subject to the obligation to produce combined accounts).

- The economic link requires that the taxable persons carry out a principal activity of the same nature or that their activities are interdependent or complementary or pursue a common economic objective.
- The organizational link is satisfied where taxable persons are, in law or in fact, under common management or organize their activities wholly or partly in cooperation with each other.

If all these conditions are met, the Group may include all the members complying with the conditions in its scope but has the power to exclude some of them. On the other hand, the Group as a single taxable person cannot be part of another Group.

The recognition of a single taxable person and its consequences

By joining a VAT Group, its members give up their status as taxable persons for VAT purposes and only the Group will have the status of a "single" taxable person for VAT purposes. This leads to the following consequences:

- "Internal" transactions between members of VAT Group will be ignored because they are carried out within the same taxable person. Only external transactions carried out on the borders by the Group with external customers and suppliers of goods and services will fall within the scope of VAT and will have to be recognized and reported by the single taxable person.
- The members will become simple sectors of activity of the VAT Group itself: however, they will be able to keep certain options that they had previously exercised (in particular, the election to make financial services subject to VAT).
- The implementation of the Group regime will automatically lead to the application of the rules laid down by the European Court of Justice which are applicable to it: in particular, as the Group is considered as a taxable person distinct from its members, transactions carried out in a headquarters/branch context can no longer be ignored and will fall within the scope of VAT (Skandia America judgment, C-7/13 17, September 2014).

The reporting obligations applicable to the representative of VAT Group have not been precisely defined at this stage. They will likely be the subject of Orders published in the course of 2021. Some practical implications can however already be anticipated:

- The members of the Group must choose from among themselves a representative which will have to fulfil all the VAT reporting obligations and who will be liable for the payment of VAT on behalf of the Group (although the members remain jointly and severally liable).
- The Group' VAT monthly return must, therefore, aggregate all transactions carried out by the members with third parties, both in terms of turnover and in terms of rights of deduction.
- Members will also be required to provide the Group's representative with information on "neutralized" transactions with other Group members, which will require that they continue to be able to monitor these "neutralized" transactions in a way not yet defined.
- A unique identification number will be assigned to the single taxable person but Group members will still be able to keep their own identification number (which is not necessarily the case when the Group has been implemented in other Member states).

The sensitive question of recovery rights

The next Finance Act should hopefully implement the VAT Group regime but should refer to an implementing decree to determine deduction rights. If each of the members is deemed to constitute a "sector of activity" of the single taxable person, the rules relating to separate sectors of activity should be able to apply within such sector (allocation rule,

deduction coefficient). Members should retain the ability to create "sub-sectors".

However, many issues should remain to be resolved in determining the rules that the single taxable person should have to comply with to determine the Group's deduction rights:

- VAT-charged expenses incurred for more than one member
- VAT-charged expenses incurred by one member for another member
- VAT-charged expenses common to all members of the Group

These questions should be likely solved in 2021.

Multiple impacts for groups wishing to elect for the VAT Group regime

While the implementation of the VAT group will make it possible to simplify and centralize the management of VAT for many groups, its actual implementation involves a number of essential steps. Although particular the question of the choice of the Group's scope is obviously strategic, an in-depth review is required to assess the changes to be made to the information systems and to ensure the tracking of transactions for reporting purposes. The definition of a reporting tool is indeed critical for the tax directions in order to face the challenges of this change.

The team of KPMG Avocats Indirect Tax is already fully involved in the operational implementation of this reform.

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