Reports of Cases

OPINION OF ADVOCATE GENERAL
KOKOTT
delivered on 23 April 2020[1]

Case C-77/19

Kaplan International Colleges UK Ltd
v
The Commissioners for Her Majesty's Revenue and Customs

(Request for a preliminary ruling
from the First-tier Tribunal (Tax Chamber), United Kingdom)

(Reference for a preliminary ruling — System of value added tax (VAT) — Directive 2006/112/EC — Exemption — Article 132(1)(f) — Supply of services by an independent cost sharing group to its members — Territorial scope — Group established in a third state — Concept of 'distortion of competition' — Relationship with group taxation (Article 11))

I. Introduction

1. The present case once again concerns the exemption for 'cost sharing groups' (Article 132(1)(f) of the VAT Directive), which has been addressed several times recently in the Court's rulings.[2] That provision exempts services supplied by an independent group of persons to its members where the group merely distributes the exact expenses arising from those services among its members (cost sharing group, also referred to by the referring court as CSG).

2. A particular feature of this case is that the group is based in Hong Kong, therefore in a third state, whilst its members are subsidiaries of a group of companies, which are all established in the United Kingdom. Almost all those members, together with other subsidiaries of that group of companies in the United Kingdom, form a VAT group for the purposes of Article 11 of the VAT Directive. It must therefore be clarified whether Article 132(1)(f) of the VAT Directive also has cross-border effects and covers CSGs in third states. If that is the case, it is necessary to clarify the relationship between this exemption and the taxation of a VAT group, the consequence of which is likewise that services supplied within such a group are not taxed.

3. The first question in particular is highly sensitive from an economic point of view. The chosen model of using a third state which, as in this case, does not have VAT enables the group to purchase nearly all services without being charged VAT and then to pass them on to its members in the United Kingdom exempt from tax. If, as in this case, those members are not entitled to deduct input tax, there are considerable potential tax savings.

1 Original language: German.

2 Judgments of 20 November 2019, *Infohos* (C-400/18, EU:C:2019:992); of 21 September 2017, *Aviva* (C-605/15, EU:C:2017:718); of 21 September 2017, *DNB Banka* (C-326/15, EU:C:2017:719); of 21 September 2017, *Commission* v *Germany* (C-616/15, EU:C:2017:721); and of 4 May 2017, *Commission* v *Luxembourg* (C-274/15, EU:C:2017:333).

II. Legal framework

A. EU law

4. The framework in EU law is defined by Article 11, Article 131 and Article 132(1)(f) of Council Directive 2006/112/EC of 28 November 2006 on the common system of value added tax ('the VAT Directive').[3]

5. The first paragraph of Article 11 of the VAT Directive gives Member States the following option:

'After consulting the advisory committee on value added tax (hereafter, the "VAT Committee"), each Member State may regard as a single taxable person any persons established in the territory of that Member State who, while legally independent, are closely bound to one another by financial, economic and organisational links.'

6. Article 131 of the VAT Directive lays down general provisions governing exemptions:

'The exemptions provided for in Chapters 2 to 9 shall apply without prejudice to other Community provisions and in accordance with conditions which the Member States shall lay down for the purposes of ensuring the correct and straightforward application of those exemptions and of preventing any possible evasion, avoidance or abuse.'

7. Under Article 132(1)(f) of the VAT Directive, which can be found in Chapter 2 concerning exemptions for certain activities in the public interest, Member States are to exempt the following transactions:

'the supply of services by independent groups of persons, who are carrying on an activity which is exempt from VAT or in relation to which they are not taxable persons, for the purpose of rendering their members the services directly necessary for the exercise of that activity, where those groups merely claim from their members exact reimbursement of their share of the joint expenses, provided that such exemption is not likely to cause distortion of competition'.

B. United Kingdom law

8. The exemption for CSGs is implemented in national law by Group 16, Schedule 9 VATA 1994, which exempts the following:

'Item No 1

The supply of services by an independent group of persons where each of the following conditions is satisfied:

(a) each of those persons is a person who is carrying on an activity ("the relevant activity") which is exempt from VAT or in relation to which the person is not a taxable person within the meaning of Article 9 of Council Directive 2006/112/EC,

(b) the supply of services is made for the purpose of rendering the members of the group the services directly necessary for the exercise of the relevant activity,

3 OJ 2006 L 347, p. 1.

(c) the group merely claims from its members exact reimbursement of their share of the joint expenses, and

(d) the exemption of the supply is not likely to cause distortion of competition'.

9. Section 43 is based on the first paragraph of Article 11 of the VAT Directive and makes provision for VAT groups. It provides:

'(1) Where under [sections 43A to 43D] any bodies corporate are treated as members of a group, any business carried on by a member of the group shall be treated as carried on by the representative member, and

(a) any supply of goods or services by a member of the group to another member of the group shall be disregarded; and

(b) any supply which is a supply to which paragraph (a) above does not apply and is a supply of goods or services by or to a member of the group shall be treated as a supply by or to the representative member; and

(c) any VAT paid or payable by a member of the group on the acquisition of goods from another member State or on the importation of goods from a place outside the member States shall be treated as paid or payable by the representative member and the goods shall be treated

(i) in the case of goods acquired from another member State, for the purposes of section 73(7); and

(ii) in the case of goods imported from a place outside the member States, for those purposes and the purposes of section 38

as acquired or, as the case may be, imported by the representative member;

and all members of the group shall be liable jointly and severally for any VAT due from the representative member.'

10. Section 43(1AA) provides:

'Where

(a) it is material, for the purposes of any provision made by or under this Act ("the relevant provision"), whether the person by or to whom a supply is made, or the person by whom goods are acquired or imported, is a person of a particular description,

(b) paragraph (b) or (c) of subsection (1) above applies to any supply, acquisition or importation, and

(c) there is a difference that would be material for the purposes of the relevant provision between

(i) the description applicable to the representative member, and

(ii) the description applicable to the body which (apart from this section) would be regarded for the purposes of this Act as making the supply, acquisition or importation or, as the case may be, as being the person to whom the supply is made,

the relevant provision shall have effect in relation to that supply, acquisition or importation as if the only description applicable to the representative member were the description in fact applicable to that body.'

11. Section 43(1AB) then provides:

'Subsection (1AA) above does not apply to the extent that what is material for the purposes of the relevant provision is whether a person is a taxable person.'

III. Facts of the case

12. The appellant in the main proceedings, Kaplan International Colleges UK Limited (KIC), operates as a holding company of other companies in the Kaplan group, which carry out educational activities. It has a number of UK subsidiaries which run higher education colleges ('international colleges') in the United Kingdom in collaboration with UK universities.

13. The tax authority (Her Majesty's Revenue and Customs, HMRC) has confirmed to KIC that the subsidiaries are currently entitled, as 'colleges of a university', to treat the educational services which they provide to students as exempt from VAT.

14. Each international college is 100% owned by KIC, save for the University of York International Pathway College (UYIPC), in which the majority share (55%) is owned by the University of York.

15. Each of KIC's international colleges has its own management and governance structure. For each international college, the university partner approves the educational programmes taught. The international colleges recruit 85% of their students through a network of 500 recruitment agents ('the agents') in 70 countries. None of the agents has an exclusive relationship with the Kaplan group. They are also entitled to work for the international colleges' direct competitors, as well as the universities directly. In return for their services, the agents receive a commission. KIC supported its agents through a number of representative offices in some of its key markets, including China, Hong Kong, India and Nigeria. The representative offices provided the agents with operational support, including marketing materials, training as to the institutions and courses being marketed, admissions and compliance procedures and so on.

16. Prior to October 2014, the agents contracted directly with KIC in the United Kingdom. Prior to October 2014, the services provided by the agents and those provided by the representative offices were also liable to UK VAT because the place of performance was in the United Kingdom. Because of an associated reverse charge to the recipients, KIC was liable for that VAT. As KIC is not entitled to deduct on account of its own exempt inputs, that VAT burden was definitive.

17. In October 2014, the international colleges (including UYIPC) established Kaplan Partner Services Hong Kong Limited (KPS). KPS is a company limited by shares which is established in Hong Kong. KIC indirectly owns just under 94% of KPS, with the remainder being indirectly owned by the University of York, through its majority ownership of UYIPC. KIC is not itself a member of the CSG (KPS).

18. Following the establishment of KPS, KIC continues to operate through a network of local representative offices and third-party agents. However, the contractual arrangements with the local representative offices and third-party agents now sit with KPS. Since 2014, both the representative office network and the independent agents have rendered their recruitment services to KPS.

19. On the inputs side, this has the following effects. The place of supply of those services is now no longer in the United Kingdom, but would, if the same VAT legislation applied in Hong Kong as in the European Union, be in Hong Kong. The services supplied would thus be subject to VAT there, if it existed. However, that is not the case. KPS receives the services in Hong Kong without being charged VAT.

20. On the outputs side, KPS supplies almost no services to non-members. KPS has, in essence, taken on responsibilities which were formerly carried out by KIC in London (United Kingdom). KPS is also responsible for managing the representative office network worldwide.

21. According to the referring court, there are three types of services which are now supplied by KPS to KIC: first, services which KPS procures from the agents, second, services which KPS procures from the representative offices and, third, services supplied by KPS dealing with matters such as compliance, together with the other activities discussed above, such as supporting the agents.

22. KIC has given evidence to the referring court that the international colleges would not seek to obtain recruitment services from an entity other than KPS. In other words, the group is certain that its services will be purchased by its members.

23. KPS charges each international college separately for the money due to accounts for the services provided to the relevant college. KPS charges each college both for its own services (e.g. compliance services) and for those procured from the representative offices on the basis of the number of students recruited for that college. KPS calculates the charges by pooling the costs and then dividing them on the basis of student numbers. Agents' marketing expenses are managed in the same way. However, agent commissions are directly attributable to individual students and are charged to the destination college for the student. Overall, no VAT is charged.

24. As a consequence, through the establishment of a CSG in Hong Kong, its members in the United Kingdom are spared entirely the VAT charged on the services formerly provided to KIC and now provided to KPS by the agents and representative offices.

25. According to the referring court, it is common ground that there were sound commercial reasons for setting up KPS in Hong Kong. It is not alleged that KPS is an artificial entity and there is no suggestion by HMRC that the establishment of KPS gives rise to an abuse of rights. It is also not in dispute that KPS provides its members, the international colleges, with the services directly necessary for the exercise of their exempt activities and that the method of charging adopted by KPS provides for exact reimbursement of each member's share of the joint expenses.

26. Each of the international colleges, save for UYIPC, also forms part of a VAT group, whose representative member is KIC.

27. By a notice of assessment of 21 April 2017, HMRC established a VAT liability in the sum of GBP 5 252 264 in respect of the period from October 2014 to July 2016 and, by a notice of assessment of 22 May 2017, a VAT liability in the sum of GBP 590 000 for October 2016. As grounds, HMRC stated that services received by KIC from KPS do not fall within the scope of the exemption from VAT for cost sharing groups and are therefore subject to the reverse change provisions in the VAT legislation. Because its outputs are predominantly exempt, that tax liability is not recoverable as input tax.

28. By a notice of appeal of 28 September 2017, KIC appealed against those decisions.

IV. Reference for a preliminary ruling

29. The First-tier Tribunal (United Kingdom) stayed the proceedings and referred the following questions to the Court of Justice for a preliminary ruling pursuant to Article 267 TFEU:

'(1) What is the territorial scope of the exemption contained in Article 132(1)(f) of Council Directive 2006/112/EC? In particular (i) does it extend to a CSG which is established in a Member State other than the Member State or Member States of the members of the CSG? And if so, (ii) does it also extend to a CSG which is established outside of the EU?

(2) If the CSG exemption is in principle available to an entity established in a different Member State from one or more members of the CSG and also to a CSG established outside the EU, how should the criterion that the exemption should not be likely to cause distortion of competition be applied? In particular,

(a) Does it apply to potential distortion which affects other recipients of similar services which are not members of the CSG or does it only apply to potential distortion which affects potential alternative providers of services to the CSG's members?

(b) If it applies only to other recipients, can there be a real possibility of distortion if other recipients who are not members of the CSG are able either to apply to join the CSG in question, or to set up their own CSG to obtain similar services, or to obtain equivalent VAT savings by other methods (such as by setting up a branch in the Member State or third state in question)?

(c) If it applies only to other providers, is the real possibility of distortion to be assessed by determining whether the CSG is assured of keeping its members' custom, irrespective of the availability of the VAT exemption — and therefore to be assessed by reference to the access of alternative providers to the national market in which the members of the CSG are established? If so, does it matter whether the CSG is assured of keeping its members' custom because they are part of the same corporate group?

(d) Should potential distortion be assessed at a national level in relation to alternative providers in the third state where the CSG is established?

(e) Does the tax authority in the EU which administers the VAT Directive bear an evidential burden to establish the likelihood of distortion?

(f) Is it necessary for the tax authority in the EU to commission specific expert evaluation of the market of the third state where the CSG is established?

(g) Can the presence of a real possibility of distortion be established by the identification of a commercial market in the third state?

(3) Can the CSG exemption apply in the circumstances of this case where the members of the CSG are linked to one another by economic, financial or organisational relationships?

(4) Can the CSG exemption apply in circumstances where the members have formed a VAT group, which is a single taxable person? Does it make a difference if, KIC, the representative member to whom (as a matter of national law) the services are supplied, is not a member of the CSG? And, if it does make a difference, is this difference eliminated by national law stipulating that the representative member possesses the characteristics and status of the members of the CSG for the purpose of applying the CSG exemption?'

30. In the proceedings before the Court, Kaplan International Colleges UK Limited, the United Kingdom and the European Commission submitted written observations and took part in the hearing on 23 January 2020.

V. Legal assessment

31. The 11 questions in total asked by the referring court essentially come under three subject headings. The first question concerns the territorial scope of the exemption in Article 132(1)(f) of the VAT Directive (see under A). The second question, with its seven sub-questions, concerns the interpretation of the criterion of an absence of distortion of competition in Article 132(1)(f) of the VAT Directive (see under B). The third and fourth questions concern the relationship between the exemption for a CSG in Article 132(1)(f) of the VAT Directive and group taxation in accordance with Article 11 of the VAT Directive (see under C).

A. Territorial scope of the exemption in Article 132(1)(f) of the VAT Directive (question 1)

32. By its first question, the referring court would like to know whether the exemption in Article 132(1)(f) of the VAT Directive extends to a CSG which is established in a Member State other than the Member State of its members and, if so, whether that is also the case if the group is established outside the EU.

33. The order for reference expressly states that the group (KPS) is established in Hong Kong and, as such, not in a Member State. The first part of the question is thus hypothetical and therefore inadmissible.[4] Consequently, it is necessary to answer only the second part of question. However, before examining the territorial scope of the rule (see under 2), it must first be determined whether it is applicable *ratione personae* (see under 1).

1. Condition: supply of services by the group to its members

34. The exemption in Article 132(1)(f) of the VAT Directive exempts only the supply of services by a group to its members. According to the order for reference, three different types of supplies are made by KPS to KIC (see point 21). However, KIC is not a member of the group (see point 17). The exemption in Article 132(1)(f) of the VAT Directive would not therefore be relevant at all.

35. On the other hand, the referring court states that it is the international colleges that are charged. They are members of the group. Furthermore, it is clear from the fourth question that in national law, under the group taxation rules based on Article 11 of the VAT Directive, KIC is notionally regarded as the relevant recipient of the services, rather than the colleges. The services thus appear to have actually been supplied to the international colleges. It is only under the national group taxation rules that they are deemed, for VAT purposes, to have been supplied to the representative member KIC.

36. In such a case, contrary to the view taken by the Commission and the United Kingdom, the exemption in Article 132 of the VAT Directive is applicable in principle.

4 With regard to this legal consequence, see, inter alia, judgment of 14 February 2019, *Vetsch Int. Transporte* (C-531/17, EU:C:2019:114, paragraph 45).

37. First of all, the supply of services to another legal entity is a de facto transaction. That de facto transaction also cannot be altered by the option provided for in Article 11 of the VAT Directive to regard multiple persons who are closely bound to one another as a single taxable person. Similarly, such group taxation for VAT purposes cannot alter the independence in civil law of persons who form a VAT group. Therefore, the services could also have been supplied to the international colleges, rather than to KIC, even though they were part of a VAT group at the time.

38. Second, this is also consistent with the spirit and purpose of the VAT group option provided for in Article 11 of the VAT Directive. The spirit and purpose of group taxation under Article 11 of the VAT Directive is primarily simplification for the benefit of the taxable person and, as a result, the tax authority.

39. That purpose is apparent from the Explanatory Memorandum for the Commission Proposal for a Sixth Council Directive on the harmonisation of legislation of Member States concerning turnover taxes from 1973. It is expressly stated with regard to Article 4(4) of the Sixth Directive (which corresponds to the current Article 11 of the VAT Directive): 'Moreover, paragraph 4 goes into finer details, so that, in the interests of simplifying administration or of combating abuses (e.g. the splitting up of one undertaking among several taxable persons so that each may benefit from a special scheme) Member States will not be obliged to treat as taxable persons those whose "independence" is purely a legal technicality.'[5] In addition, this also follows from the Court's case-law, which likewise stresses the simplification purpose of Article 11 of the VAT Directive.[6]

40. In all-phase taxation with deduction of input VAT, this administrative simplification means, in essence, that no (VAT) invoices have to be issued for services supplied within the group. Furthermore, not every member of the group is required to submit its own tax return (with a calculation of the tax liability and deduction); rather, only the 'head' of the group must make a single tax return. Consequently, the tax authority no longer has to manage multiple taxable persons, but only a single taxable person, which is effectively liable for the tax debts of the members of its group.

41. If, however, the spirit and purpose of Article 11 of the VAT Directive is primarily simplification for the taxable person and the tax authority, Article 11 of the VAT Directive also refers solely to the relationship between the taxable person (and its persons who are closely bound to one another) and the tax authority.

42. For the tax authority, there is notionally a single taxable person for VAT purposes, to which all the group's transactions are attributed. However, that VAT group cannot act externally as a separate legal entity and, contrary to the submissions made by the United Kingdom and the Commission at the hearing, establish a CSG pursuant to Article 132(1)(f) of the VAT Directive or be part of such a group. The members of the CSG are the persons who establish the group by virtue of their own legal capacity, in this case the individual international colleges.

43. The loss of independence for VAT purposes (in accordance with Article 11 of the VAT Directive) is thus confined solely to the relationship between the companies which are closely bound to one another and the tax authority. It has no effects vis-à-vis third parties. In most cases, a third-party undertaking does not even know (or cannot verify) whether or not its customer is part of a VAT group. A supplier must therefore, for example, indicate its contractual partner as the customer in the invoice pursuant to Article 226(5) of the VAT Directive, and not the VAT group or its representative member, which it does not know.

5 See the Explanatory Memorandum on Article 4(4) on page 4 of the Commission proposal of 20 June 1973, COM(73) 950 final.

6 Judgments of 16 July 2015, *Larentia + Minerva and Marenave Schiffahrt* (C-108/14 and C-109/14, EU:C:2015:496, paragraph 40); of 25 April 2013, *Commission* v *Sweden* (C-480/10, EU:C:2013:263, paragraph 37); and of 9 April 2013, *Commission* v *Ireland* (C-85/11, EU:C:2013:217, paragraphs 47 and 48).

44. A distinction must therefore be made. If KPS originally supplied to KIC any services which KIC itself used or possibly sold on to third parties or the individual international colleges, an exemption under Article 132(1)(f) of the VAT Directive is ruled out a priori because KIC is not a member of CSG.

45. The situation may be different for services supplied to the international colleges, however, even if under national group taxation legislation they are deemed to be represented by KIC. This factual point — the person to whom the individual services were actually supplied — cannot be clarified by the Court, but only by the referring court.

46. It will therefore be presumed below that, contrary to the statements made by the referring court in the order for reference, the three types of services mentioned there (listed in point 21 above) were supplied not to KIC, but de facto to each of the individual international colleges, which are the members of the CSG (KPS). Only then does the question of the exemption under Article 132(1)(f) of the VAT Directive arise.

2. Group established in a third state

47. On this basis, it must be decided whether the exemption in Article 132(1)(f) of the VAT Directive also covers services supplied by a group established in a third state to its members established in a Member State. This question — which I have already addressed in detail in my Opinions in *Aviva* and *DNB Banka*[7] and which the Court was able to leave open in its earlier decisions[8] — should be answered in the negative, as the Commission and the United Kingdom maintain.

(a) Wording, historic and schematic interpretation of the provision

48. Admittedly, at first sight, the wording of Article 132(1)(f) of the VAT Directive does not include any geographical restriction. Nor does the legislature expressly confine its sphere of action to the territory of a single Member State, as it does in other provisions (such as the first paragraph of Article 11 of the VAT Directive). Nevertheless, there are also rules which relate explicitly to cross-border activities of the taxable person (see Article 148(e) of the VAT Directive — 'airlines operating for reward chiefly on international routes').

49. It can thus be stated at most that the wording neither requires one thing nor precludes the other. It is not possible to infer from the wording an argument to the effect that CSGs in third states are also covered.

50. A look at the predecessor provision, the Sixth Directive,[9] explains why, unlike in the case of Article 11 of the VAT Directive, an express restriction cannot be found in the wording.

7 See my Opinions in *Aviva* (C-605/15, EU:C:2017:150, point 36 et seq.) and *DNB Bank* (C-326/15, EU:C:2017:145, point 45 et seq.).

8 Judgments of 21 September 2017, *Aviva* (C-605/15, EU:C:2017:718), and of 21 September 2017, *DNB Banka* (C-326/15, EU:C:2017:719).

9 Sixth Council Directive 77/388/EEC of 17 May 1977 on the harmonisation of the laws of the Member States relating to turnover taxes — Common system of value added tax: uniform basis of assessment (OJ 1977 L 145, p. 1).

51. The exemption in Article 132(1)(f) of the VAT Directive was formerly laid down in Article 13 of the Sixth Directive. According to the heading, this covered only 'exemptions within the territory of the country'. No material changes were connected with the recast version.[10] Consequently, having regard to the Sixth Directive, an exemption within the territory of the country can also be considered to cover only services supplied by a group established in the territory of the country to its members there.

52. This narrower interpretation is also suggested by the scheme of the exemptions in Title IX of the VAT Directive. Chapters 1 to 3 do not require a specific cross-border transaction. Only Chapters 4 to 8 and 10 contain specific exemptions for cross-border transactions. If the exemption were intended to have related to cross-border CSGs, the legislature would have made provision to that effect there.

53. It must be concluded that, by Article 132(1)(f) of the VAT Directive (at the time Article 13(A)(1)(f)), the EU legislature did not have in view cross-border groups — certainly not those in a third state — but, in connection with 'exemption within the territory of the country', 'groups established in the territory of the country'.

(b) Inconsistency with Article 11 of the VAT Directive

54. In particular, this interpretation — that is, restricting independent groups for the purposes of Article 132(1)(f) of the VAT Directive to the territory of one Member State — avoids an inconsistency with Article 11 of the VAT Directive, which permits Member States to regard as a single taxable person 'any persons established in [their] territory' who are 'closely bound to one another' in a certain manner through a group. Only undertakings established in the same Member State can therefore form a group pursuant to Article 11.

55. The exemption in Article 132(1)(f) of the VAT Directive lays down less stringent requirements with respect to the nature of the group than Article 11. It does not require the undertakings to be closely bound to one another. It would therefore be inconsistent on this basis to allow a cross-border VAT exemption which cannot be achieved by the provision imposing stricter conditions.

56. This is very clear in the present case. KPS could, in principle, also be part of the KIC VAT group ('closely bound to one another'). Article 11 of the VAT Directive expressly restricts non-taxation to the United Kingdom. Why then should a similar outcome (no taxation of services supplied by the group to its members) be achievable under Article 132(1)(f) of the VAT Directive?

57. That inconsistency can be resolved only if the effects of Article 132(1)(f) of the VAT Directive, like those of Article 11 of the VAT Directive, are also confined to one Member State, which presupposes that the group and the member to which a service is supplied are established in the same Member State.

58. Moreover, both provisions are underpinned by the same rationale. Restricting the provision's application to the territory of one country ensures that one Member State does not encroach upon the tax jurisdiction of another Member State by allowing group taxation or the formation of an equivalent independent group, the conditions governing which are not open to ready scrutiny by that other Member State. At the same time, such a restriction ensures that the different tax authorities do not adopt contradictory decisions. The main reason would, however, appear to be to prevent different tax rates or different tax regimes being exploited. This is particularly clear in the case of third states (including their special administrative regions) which do not necessarily have VAT, as in this case.

10 According to recital 3, with the adoption of the VAT Directive only the structure and the wording were recast, without any intention to make material changes in the existing legislation. Nevertheless, material changes were made, as listed exhaustively in the provisions governing transposition and entry into force of the directive. There is nothing to this effect in relation to Article 132(1)(f) of the VAT Directive.

(c) Existence of different tax rates (tax rate issue)

59. The adoption of a cross-border CSG enables a tax optimisation model that is very easy to set up, particularly for groups of companies which operate globally and carry out exempt transactions (that is to say, which do not confer entitlement to deduct input tax). The latter simply have to form with those of their affiliates that operate in Europe a group established in a State with the lowest tax rate or no VAT (such as the United States or, as in this case, Hong Kong). That group could then purchase all the services that had previously been subject to VAT from third parties.

60. Since, in those circumstances, the place of supply would usually be in that State where there is no VAT or only low VAT, such a group would be charged little or no VAT. The group would then 'sell on' the purchased services to its members at cost. It is true that the place of supply would then be in the Member States concerned. However, the transaction would be exempt from VAT there pursuant to Article 132(1)(f) of the VAT Directive.

61. Leaving aside the question as to how, in such circumstances, the Member States concerned would be able to verify the absence of distortion of competition or compliance with the other criteria for the applicability of that provision (see below, point 67 et seq.), this could easily reduce the intra-group VAT burden.[11] A VAT group as provided for in Article 11 of the VAT Directive, on the other hand (see above, point 54 et seq.), could not have achieved such an outcome.

62. The same conclusion must be drawn in the light of the fundamental freedoms. Even if the fundamental freedoms were applicable in that situation involving a third state, a territorial restriction of the exemption in Article 132(1)(f), like that of the VAT group in accordance with Article 11 of the VAT Directive, would be justified by the need to preserve the allocation of the power to impose taxes between Member States.[12] Such a restriction is also justified by the need to guarantee the effectiveness of fiscal supervision. If, on the other hand, the view was taken that restricting the exemption to the territory of one Member State infringes EU law, the question would logically arise whether Article 11 of the VAT Directive was also contrary to EU law. There are serious doubts in this regard, however.[13]

63. In so far as KIC asserts[14] that this risk of exploitation of different tax rates is negligible because the exemption in Article 132(1)(f) of the VAT Directive covers only the activities in the public interest referred to in Article 132 of the VAT Directive, this is surprising. First, the size of the tax base in question can hardly be inferred from the nature of the activity (exempt activity in the public interest). This is readily demonstrated by the education and health sectors, which are certainly not insignificant.

64. Second, that view runs counter to the clearly discernible will of the legislature. The activities listed in Article 132 of the VAT Directive are exempt only partially (in respect of the value added at the last stage of the value creation chain), and not in full.

11 A similar tax optimisation model results if the Member State with the lowest rate of VAT within the EU is chosen as the place of establishment of the group.

12 With regard to this justification, see, for example, judgments of 13 December 2005, *Marks & Spencer* (C-446/03, EU:C:2005:763, paragraphs 45 and 46); of 29 November 2011, *National Grid Indus* (C-371/10, EU:C:2011:785, paragraph 48); of 21 May 2015, *Verder LabTec* (C-657/13, EU:C:2015:331, paragraph 47); and of 21 January 2010, *SGI* (C-311/08, EU:C:2010:26, paragraph 60).

13 This position is also rejected in Ehrke-Rabel, T., *VAT grouping: the relevance of the territorial restriction of Article 11 of the VAT Directive*, World Journal of VAT/GST Law, vol. 1, no 1, July 2012, p. 61 (70 et seq.); Casper Bjerregaard Eskildsen, *VAT Grouping versus Freedom of Establishment*, 20 EC Tax Review, Issue 3, pp. 114–120; see also, in detail, Stadie, H. in Rau/Dürrwächter, *UStG*, § 2, note 812 et seq. (as at 174th update — October 2017).
A different view is taken, however, in van Doesum, A., van Kesteren, H., van Norden, G.-J., *The Internal Market and VAT: intra-group transactions of branches, subsidiaries and VAT groups*, (2007) 16 EC Tax Review, Issue 1, p. 34 (41).

14 See paragraph 56 et seq. of the written observations.

65. Had the legislature intended to reduce the entire VAT burden for recipients of activities in the public interest (such as education or medical treatment services), it would also have added the exemption in Article 132 of the VAT Directive into Article 169 of the VAT Directive and permitted a deduction to be made despite exempt outputs. However, it deliberately did not utilise that instrument, of which it was aware.

66. The legislature's deliberate decision in favour of only partial exemption is, however, entirely undermined by the arrangement chosen by KIC (establishing a CSG in a third state without a VAT system).

(d) Evaluation of the absence of distortions of competition

67. The fact that the exemption provided for in Article 132(1)(f) of the VAT Directive, as the wording of that provision makes clear, must not cause distortion of competition, which the national tax authority must be able to verify, also indicates that the exemption should be confined to a single Member State. In any event, this precludes a CSG in a third state.

68. The tax authorities are hardly able to carry out a cross-border evaluation of the existence of distortions of competition in different states, particularly in third states (such as Hong Kong in this case). To this extent, the Court's approach to Article 13 of the VAT Directive in *Isle of Wight Council*[15] may also be applied to Article 132(1)(f) of the VAT Directive.

69. In that judgment, the Court stressed the difficulties in determining distortions of competition in markets whose demarcation does not necessarily coincide with the areas over which the local authorities exercise their powers. That situation is likely to jeopardise the principles of fiscal neutrality and legal certainty, all the more so in in situations involving third states.

70. It is also important to take into account the fact, made explicit in Article 131 of the VAT Directive, that the Member States must ensure the correct and straightforward application of Article 132 of the VAT Directive. This would be effectively impossible, however, if a single tax authority had to evaluate the presence of any distortions of competition across the globe or if several tax authorities carried out different — and possibly contradictory — evaluations. Indeed, the latter scenario would actually create distortions of competition.[16] The considerable practical difficulties of applying and monitoring the scheme in such circumstances also militate against the inclusion of groups established in third states.

3. Conclusion

71. Article 132(1)(f) of the VAT Directive must therefore be interpreted to the effect that the supply of services by a group in a third state is not covered by the exemption. The services supplied by KPS to the international colleges are thus not exempt, with the result that there is no need to answer the other questions asked by the referring court.

15 Judgment of 16 September 2008, *Isle of Wight Council and Others* (C-288/07, EU:C:2008:505, paragraph 49 et seq.).

16 This arises where a group deducts input tax in a particular country because that country has refused to grant the VAT exemption on the ground that it assumes such distortions of competition to be present. In the Member State where the recipient of the supply is situated, on the other hand, because the VAT is reverse-charged to the group member, the transaction is assumed to be exempt on the ground that no distortions of competition are observed there.

B. In the alternative: interpretation of the criterion of an absence of 'distortion of competition' (question 2)

72. If, on the other hand, the Court were to take the view that groups established in a third state are also covered by Article 132(1)(f) of the VAT Directive, it is necessary to examine the other questions asked by the referring court.

73. The seven sub-questions asked as part of the second question all hinge on what criteria are to be used for assessing when there is distortion of competition within the meaning of Article 132(1)(f) of the VAT Directive, precluding the exemption which intrinsically exists.

74. In so far as the referring court asks for an assessment in connection with a group in another Member State, this question is hypothetical and thus inadmissible, as has already been stated (point 33). The second question should be examined only in so far as it relates to a group established in a third state.

1. Purpose of the provision

75. As the Court has already ruled[17] and I have stated elsewhere,[18] Article 132(1)(f) of the VAT Directive is intended to offset the *competitive disadvantage* of smaller undertakings by comparison with a larger competitor. The latter can procure the services supplied by the group from its own employees or in a VAT group from a closely related company. As the Commission rightly states,[19] Article 132(1)(f) of the VAT Directive is intended to ensure equal VAT treatment of large and small undertakings, the need for which stems from the exclusion of the deduction for exempt outputs.

76. This is illustrated by the following example. A large hospital which is able to provide meals for its patients itself (through its own kitchen staff) is not charged VAT in respect of the staff costs arising. A small hospital that cannot utilise such staff has just two options.

77. It can engage a third party to provide meals. VAT will be incurred both on material costs and on the third party's staff costs for its kitchen staff. This VAT burden is definitive as far as the hospital is concerned (there is no right of deduction on the basis of the exempt outputs — see Articles 168 and 169 of the VAT Directive). It must therefore accept higher costs than the competitor in order to be able to offer the same services. This is a competitive disadvantage stemming primarily from the size of the undertaking.

78. Article 132(1)(f) of the VAT Directive makes it possible, however, to avoid this competitive disadvantage. The abovementioned hospital can form a group with another hospital. The group engages the staff who are then sufficiently utilised by the two members and provide meals for both hospitals. The relevant costs are split between the two. Because the service supplied by the group to its members is exempt, VAT is now not charged on staff costs (the input VAT burden remains the same for material costs). The competitive disadvantage suffered by the two smaller hospitals compared with the (larger) competitor would thus be eliminated.

17 See, to that effect, judgments of 20 November 2019, *Infohos* (C-400/18, EU:C:2019:992, paragraph 36); of 21 September 2017, *Commission* v *Germany* (C-616/15, EU:C:2017:721, paragraph 56); and of 11 December 2008, *Stichting Centraal Begeleidingsorgaan voor de Intercollegiale Toetsing* (C-407/07, EU:C:2008:713, paragraph 37). See also Opinion of Advocate General Mischo in *Taksatorringen* (C-8/01, EU:C:2002:562, point 118).

18 My Opinions in *Aviva* (C-605/15, EU:C:2017:150, point 20 et seq.) and *DNB Banka* (C-326/15, EU:C:2017:145, point 51).

19 See paragraph 11 of the written observations.

79. If, however, that exemption is intended to eliminate a competitive disadvantage, the grant of it cannot normally at the same time give rise to distortion of competition or create the risk of distortion of competition. The competition clause contained in Article 132(1)(f) of the VAT Directive seems somewhat unusual in this regard and makes little sense. [20]

2. Need for a restrictive interpretation of the criterion of distortion of competition

80. For this reason, it would seem that a restrictive interpretation must be adopted if the exemption in Article 132(1)(f) of the VAT Directive is not to be redundant.

81. The same conclusion is reached if the absence of distortion of competition is understood as an exception to the exemption provided for, in principle, in Article 132(1)(f) of the VAT Directive since, according to the Court, any exception to or derogation from a general rule is to be interpreted strictly. [21]

82. If, however, the absence of distortion of competition is regarded as an exception to the exemption, which is in turn regarded as an exception to the general principle that VAT is to be levied, [22] a counter-exception could also be taken to exist. Such a counter-exception could be interpreted either very strictly (as an exception, which is to be interpreted strictly, to an exception) or very broadly (as a counter-exception to an exception which is to be interpreted strictly).

83. Irrespective of this, however, this 'counter-exception' would also have to be interpreted strictly. According to the Court's case-law, the interpretation must be consistent with the objectives pursued by those exemptions and comply with the requirements of fiscal neutrality. In particular, the terms used to specify the exemptions referred to in Article 132 may not be construed in such a way as to deprive the exemptions of their intended effects. [23]

84. That would be the case if a distortion of competition were generously assumed to exist. In essence, this is consistent with the above (point 80) strict, teleological interpretation of the criterion of an absence of 'distortion of competition'.

85. A starting point for such a restrictive interpretation is offered by the Court's case-law to the effect that a finding of a distortion of competition requires there to be a genuine risk that the exemption may by itself, immediately or in the future, give rise to distortions of competition. [24] In this case the distortion of competition relates to the exemption of services supplied by the group. [25] That exemption prevents third-party suppliers from being able to provide those services at the same price to members of the group (answer to question 2a; hence there is no need to answer question 2b).

20 See, to that effect, Opinion of Advocate General Mischo in *Taksatorringen* (C-8/01, EU:C:2002:562, point 125 et seq.): 'it must be said that it [the market] is a thoroughly unusual one'. See also my Opinion in *Aviva* (C-605/15, EU:C:2017:150, point 67).

21 See, inter alia, judgment of 28 September 2006, *Commission* v *Austria* (C-128/05, EU:C:2006:612, paragraph 22 and the case-law cited).
See also, in connection with exemptions under the VAT Directive, judgments of 21 September 2017, *Aviva* (C-605/15, EU:C:2017:718, paragraph 30); of 21 September 2017, *Commission* v *Germany* (C-616/15, EU:C:2017:721, paragraph 49); and of 5 October 2016, *TMD* (C-412/15, EU:C:2016:738, paragraph 34 and the case-law cited).

22 As was expressly held with regard to the exemptions under Article 132 of the VAT Directive in the judgment of 21 September 2017, *Aviva* (C-605/15, EU:C:2017:718, paragraph 30).

23 Judgments of 20 November 2019, *Infohos* (C-400/18, EU:C:2019:992, paragraph 30); of 4 May 2017, *Commission* v *Luxembourg* (C-274/15, EU:C:2017:333, paragraph 50); of 28 November 2013, *MDDP* (C-319/12, EU:C:2013:778, paragraph 25); of 21 March 2013, *PFC Clinic* (C-91/12, EU:C:2013:198, paragraph 23); of 11 December 2008, *Stichting Centraal Begeleidingsorgaan voor de Intercollegiale Toetsing* (C-407/07, EU:C:2008:713, paragraph 30); of 14 June 2007, *Horizon College* (C-434/05, EU:C:2007:343, paragraph 16); and of 20 June 2002, *Commission* v *Germany* (C-287/00, EU:C:2002:388, paragraph 47).

24 See judgments of 20 November 2019, *Infohos* (C-400/18, EU:C:2019:992, paragraph 48), and of 20 November 2003, *Taksatorringen* (C-8/01, EU:C:2003:621, paragraph 64).

25 Judgment of 20 November 2019, *Infohos* (C-400/18, EU:C:2019:992, paragraph 47).

86. In the light of the necessary restrictive interpretation of the criterion of an absence of distortion of competition, such a distortion cannot be established solely on the basis of the existence of a commercial market. It would reduce to absurdity the rationale behind Article 132(1)(f) of the VAT Directive, according to which it should be possible to avoid the competitive disadvantage in relation to larger competitors (see above, point 75) specifically through cooperation with other undertakings (answer to question 2g).

87. If the group could be established in a third state, the distortions of competition caused by its services at national level would logically also have to be examined in relation to other service suppliers from the third state in which the group is established. Third-party intermediaries within the United Kingdom and elsewhere would suffer a competitive disadvantage and would not be able to supply identical services to the international colleges in the United Kingdom, as the cost of their services would be increased by the VAT due in the United Kingdom (answer to question 2d).

88. In determining the existence of distortion of competition it must be examined whether the group can be certain of keeping its members' custom even if there is no exemption.[26] If the services supplied by the group are tailored to the needs of the members such that the group can also be certain that the members will purchase those services, there is, in principle, cooperative action (see above, point 75 et seq.), which is intended to be exempt under Article 132(1)(f) of the VAT Directive (answer to question 2c).

89. Members of a group usually only ever come together if they are certain that those members will also purchase the group's services ('purchasing guarantee'). It can thus be assumed in principle that the formation of a group will not cause distortion of competition within the meaning of Article 132(1)(f) of the VAT Directive.

90. In view of the purpose of the exemption (preventing a competitive disadvantage), the criterion requiring that there should be no distortion of competition can, in my view, serve solely to avoid abuse (see Article 131 of the VAT Directive). It should thus simply serve to ensure that the exemption is not applied inappropriately. It is possible to ascertain when that is the case only on the basis of indications.

91. In the light of the purpose of the criterion, which serves primarily to avoid abuse, the tax authority bears the burden of proof[27] for demonstrating the existence of the abuse to be prevented or indications to that effect (answer to question 2e). No rule of EU law requires the tax authority to commission a specific expert evaluation of the market of the third state. It is not a matter of EU law how the national tax authorities satisfy the burden of proof, but of national law of tax procedure (answer to question 2f).

3. Indications of distortion of competition

92. An indication that the exemption provided for in Article 132(1)(f) of the VAT Directive is being applied inappropriately may be, for example, that the group supplies the same services to a significant extent for consideration to non-members and is to that extent, by exploiting effects of synergy, operating on the market primarily as a competitor and less as a cooperative group. This could, under certain circumstances, constitute a correspondingly genuine risk of distortion of competition in relation to the abovementioned third-party suppliers.

26 See judgment of 20 November 2003, *Taksatorringen* (C-8/01, EU:C:2003:621, paragraph 59), and Opinion of Advocate General Mischo in *Taksatorringen* (C-8/01, EU:C:2002:562, point 131 et seq.).

27 With regard to the burden of proof for demonstrating the existence of an abusive practice in VAT law, see, for example, judgment of 10 July 2019, *Kuršu zeme* (C-273/18, EU:C:2019:588, paragraphs 35 and 38).

93. Yet another indication may be that the group does not supply any services tailored to the specific needs of its members, but only sells on the purchased services. Those services could just as easily be offered and received by others. Here, too, third-party suppliers would be forced from the market in question. This could possibly be the case here to some degree, as the services supplied by the group manifestly consisted largely in simply passing on to members the services received from third parties (agents etc.).

94. Purchasing services and passing on those purchased services without modification in this manner also runs counter to the nature of the exemption outlined above, which does not seek to optimise the mere purchase and selling on of services, but to enable cooperative action between smaller market participants in order to offset a competitive disadvantage in relation to larger competitors which supply those services themselves (see above, point 75 et seq.).

95. Where services are simply purchased and passed on without modification, the group does not supply a service itself. There is then no competitive disadvantage in relation to competitors that purchase the services themselves, as they are subject to the same VAT. The situation would be different if the group created its own added value. That would be the case, for example, if the agents were employed by the group itself, so that the group itself supplied agency services. There would then also be the element of cooperation on which the exemption in Article 132(1)(f) of the VAT Directive is based.

96. Another indication may be that the primary purpose of the group's formation is simply to optimise the input VAT burden rather than to establish reciprocal cooperation with a view to avoiding a competitive disadvantage. An optimisation of the input VAT burden can be taken to exist where a competitive advantage is created by shifting any necessary peripheral services received to a group in a state with a very low VAT rate or even no VAT. This too could certainly be the case here.

97. However, all of this must ultimately be assessed by the referring court.

C. In the alternative: relationship with group taxation under Article 11 of the VAT Directive (questions 3 and 4)

98. In the event that the Court concludes that a group in a third state is also covered by the exemption in Article 132(1)(f) of the VAT Directive and, despite the indications available, the referring court finds that there is no distortion of competition, it is still necessary to answer the third and fourth questions.

99. These two questions concern the relationship between Article 132(1)(f) of the VAT Directive and the group taxation option under Article 11 of the VAT Directive. The United Kingdom has exercised that option. The specific point at issue is whether and under what conditions members of a VAT group can at the same time be members of a CSG.

100. There is agreement between the Commission and the United Kingdom that only services supplied by the CSG to its independent members are exempt from VAT. The existence of a VAT group prevents services being supplied to the members of the CSG because they lose their independence on the basis of the rules on VAT groups. In so far as all the international colleges which established KPS are part of a VAT group, there would no longer be multiple members of the CSG, but a single member.

101. This is a very formal approach, which, as I have already explained (see above, point 34 et seq.), I do not consider to be correct. Furthermore, Article 132(1)(f) of the VAT Directive refers to a group 'of persons'. Persons who are independent in civil law continue to be persons, even if they form part of a VAT group. In addition, the directive uses the expression 'independent groups' and not 'groups of independent persons', as KIC also rightly notes in the written observations.

102. The 'independence' must therefore hold only for the group and not for the members of the group. It is common ground in the present case that the fiction of the lack of independence of the group through group taxation cannot apply (for KPS). Article 11 of the VAT Directive expressly precludes a cross-border effect.

103. As KIC maintains and contrary to the submissions made by the Commission at the hearing, the term 'person' in Article 132(1)(f) of the VAT Directive does not mean a 'taxable person', and certainly not the notion of taxable person extended by way of a fiction under Article 11 of the VAT Directive. This is made clear by the wording of Article 132(1)(f) of the VAT Directive, which also refers to persons who are carrying on an activity in relation to which they are not 'taxable persons'. It is therefore also possible for non-taxable persons to be members of a group.

104. In this regard, the creation of a VAT group based on the fiction of a single taxable person pursuant to Article 11 of the VAT Directive (regarding multiple persons 'as a single taxable person') does not, as such, preclude the existence of a CSG of persons. Nor does it preclude the CSG supplying services to its members.

105. This becomes clear if the example above (point 76 et seq.) is modified slightly. Another smaller hospital (C), together with hospitals A and B, forms a CSG (Z) within a Member State, which takes over providing meals for patients. However, A is then purchased by X and is now part of a VAT group, the head of which (in the United Kingdom, the representative member) is X. Z continues to supply services to A, B and C, whose independence in company law is not affected by Article 11 of the VAT Directive.

106. It seems doubtful that the exemption of the services supplied by Z to A should in fact depend on the fact that those services are now deemed, for VAT purposes, to be services supplied to X, and X is not formally part of the group. As was stated above (points 38 and 39), the spirit and purpose of group taxation is administrative simplification and not making the exemption for a CSG dependent on the subsequent company structure of its members or the existence of group taxation arrangements.

107. The need for VAT-neutral cooperation between A, B and C also does not cease to apply because A has now become part of the VAT group of X. Nothing has altered as regards the competitive disadvantage of A, B and C compared with a correspondingly large competitor.

108. Contrary to the view taken by the Commission and the United Kingdom, the two 'systems' (group taxation and exemption of services supplied by a CSG) are not therefore mutually exclusive in principle. They merely have to be coordinated with one another.

109. Article 11 is a *lex specialis* in relation to Article 132(1)(f) of the VAT Directive only where the members of the CSG are persons who are all part of a single VAT group. Group taxation under Article 11 of the VAT Directive is the more extensive provision, as it does not tax any services supplied within the group. Article 132(1)(f) of the VAT Directive, on the other hand, exempts only services supplied by a CSG to its members (and not vice versa or between members). Article 11 thus prevails over the application of Article 132(1)(f) of the VAT Directive.

110. The fact that some members of the CSG are also part of a VAT group in the United Kingdom does not therefore preclude the application of the exemption in Article 132(1)(f) of the VAT Directive.

VI. Conclusion

111. I therefore propose that the Court should answer the questions referred by the First-tier Tribunal (United Kingdom) as follows:

(1) The exemption in Article 132(1)(f) of Council Directive 2006/112/EC of 28 November 2006 on the common system of value added tax ('the VAT Directive') does not extend to a group which is established in a third state.

(2) Article 132(1)(f) of the VAT Directive is to be interpreted to the effect that the exemption of services supplied by a group to its members in return for exact reimbursement of their share of the expenses does not, in principle, cause distortion of competition unless it is applied inappropriately.

Indications of inappropriate use may be, for example:

(1) that the group supplies the same services to a significant extent for consideration to non-members and is to that extent operating on the market primarily as a competitor and less as a cooperative group;

(2) that the group does not supply any services tailored to the specific needs of its members, but only passes on purchased services; or

(3) that the primary purpose of the group's formation is simply to optimise the input VAT burden rather than to establish reciprocal cooperation with a view to avoiding a competitive disadvantage.

The tax authority bears the burden of proof for demonstrating these indications. It is not, however, required by EU law to commission a specific expert evaluation or similar. The referring court must ultimately assess these indications.

(3) The fact that some members of the CSG are also part of a VAT group does not preclude the application of the exemption in Article 132(1)(f) of the VAT Directive. However, the more extensive group taxation on the basis of Article 11 of the VAT Directive prevails. The exemption in Article 132(1)(f) of the VAT Directive does not therefore apply where all the members of the CSG are part of a single VAT group.