

VAT treatment of associations of persons 3/13/23



Manager, Tax, PwC Latvia
Matiss Auzins

Two or more individuals or entities may combine forces or funds under a partnership agreement to achieve a common goal. Each partner should make a contribution (cash, property or work) to the partnership and any assets acquired through the joint business of the partners are their joint property. The partners share in profits that are essentially due to them.

The Latvian VAT Act, the relevant rules and the tax authority's guidance are silent on how VAT should be applied in this situation and how an association of persons created under a partnership agreement could operate as a taxable person.

In its ruling C-519/21 of 16 February 2023, the Court of Justice of the European Union (CJEU) examined the VAT treatment of persons having entered into an association agreement under Romanian law. The association agreement could essentially be equated with a partnership agreement within the meaning of the Latvian Civil Code. This article explores CJEU findings.

Background

Two sisters (ASA and PP), who owned a piece of land in equal shares, set up in business with two other individuals (BP and MP). They entered into an association agreement under Romanian law, which doesn't create a person with legal entity status. The purpose of forming the association was to build eight residential buildings with 56 apartments for sale. The association agreement provided that BP and MB jointly covered expenses incurred in building the apartment complex, while design work, obtaining construction permits and handling all necessary administrative documents as well as selling the apartments constituted a joint obligation of the parties. They had also agreed on the distribution of profits. All construction-related invoices were issued in the name of BP and MB.

The agreement between the parties provided that MB and BP would enter into contracts of sale under a power of attorney in the name and on behalf of ASA and PP. The apartments were entered on the land register as separate properties of ASA and PP or as their joint property. The contracts of sale made no other reference to BP, MB or the association agreement. The association of persons operating under the association agreement was not registered for Romanian VAT, and Romania had not passed the VAT directive's provisions relating to a VAT group as a separate taxable person.

Questions heard by the CJEU

The CJEU assessed whether an association of persons being created under an association agreement, which is not a legal entity and is not registered with the tax authority before starting its business, is treated as a taxable person. The ruling emphasises that the term "taxable person" is a broad one and presumes independence in doing business. The VAT directive provides that a taxable person is any person that independently carries on any business at any place regardless of its goal or result. So all persons that objectively meet the prescribed criteria – individuals or entities, public or private, and even entities without legal entity status – are treated as taxable persons. The CJEU finds that we should primarily assess

whether the business has been conducted independently and by whom. The independence criterion applies to the question of how the transaction is linked to a particular individual or entity and guarantees that the buyer may safely exercise their right to deduct input VAT. For this purpose, we need to verify that the person carries on business in its own name and on its own account, as well as being responsible for itself, i.e. takes economic risk associated with its business.

Under the association agreement, selling the apartments was a joint obligation of the parties. However, the notarised contracts of sale provided that proceeds from the sale were due to ASA and PP as the property owners, with no reference to BP, MB or the association agreement. The situation remains unchanged by the fact that BP and MB had entered into the contracts of sale under a power of attorney because the legal consequences of the contracts apply to ASA and PP only. This implies that with respect to the property transfer, BP and MB cannot be treated as persons having independently carried on business, so they don't have taxable person status within the meaning of the VAT directive.

The CJEU also assessed whether the persons operating under the association agreement may be treated as a single taxable person. To resolve this issue, the CJEU analysed article 11 of the VAT directive, which states that persons who carry on business in a member state and, while being legally independent, are closely linked to one another through financial, economic and organisational ties, may be treated as a single taxable person. A similar provision in the VAT Act governs the operations of a VAT group. The CJEU has stated that the purpose of this provision is to allow the member states to avoid linking a taxable person's characteristics to legal "independence". However, the CJEU has stated that being equated with a single taxable person prevents the taxable persons from continuing to file separate VAT returns and to be identified as taxable persons within or outside the VAT group.

The CJEU has emphasised that a member state has discretion to adopt restrictions on treating multiple independent taxable persons as a single one, but only to prevent malicious practices or actions. The CJEU has also stated that a member state's law demanding that a group of taxable persons be registered with the tax authority before making taxable supplies is justified. Since the association of persons operating under the association agreement was not registered for Romanian VAT, the CJEU didn't further assess how the association could operate as a separate taxable person, yet it's clear that an association of persons without legal entity status may be a taxable person.

The other question assessed by the CJEU was whether a taxable person without an invoice issued in their name may deduct the input VAT that another member of the association has paid to carry on its business.

The CJEU named the following substantive conditions for input VAT deduction:

1. The person wishing to exercise deduction rights must be a taxable person.
2. The taxable person must use the acquired goods or services for its taxable purposes.
3. The goods or services have been supplied by another taxable person.

The formal requirements provide that the taxable person must have an invoice that complies with the rules for its mandatory content. The CJEU has stated earlier that deduction rights stand if the substantive conditions for input VAT deduction are met, even if the taxable person has failed to meet certain formal requirements. This is permissible if the tax authority has the necessary information to verify that all the conditions for input VAT deduction have essentially been met.

Interestingly, in the case of an association agreement, the CJEU didn't clearly deny the right of the land owners (ASA and PP) to deduct input VAT, even though all the construction-related invoices had been issued to BP and MB, who were responsible for building the apartment complex. The CJEU recognised that

deduction rights may exist if ASA and PP are able to present objective evidence that taxable persons actually supplied the goods or services to ASA and PP for making taxable supplies. However, the CJEU didn't specify what could serve as evidence in the case of an association agreement.