EUROPEAN COMMISSION
DIRECTORATE-GENERAL
TAXATION AND CUSTOMS UNION
Indirect Taxation and Tax administration
Value added tax

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Brussels, 22 September 2015

VALUE ADDED TAX COMMITTEE
(ARTICLE 398 OF DIRECTIVE 2006/112/EC)
WORKING PAPER NO 879

CASE LAW

ISSUES ARISING FROM RECENT JUDGMENTS OF THE COURT OF JUSTICE OF THE EUROPEAN UNION

ORIGIN:	**Commission**
REFERENCES:	**Articles 2(1), 9 and 11**
SUBJECT:	**CJEU Case C-7/13 *Skandia America*: VAT grouping – the point of view of the VAT Expert Group**

1. INTRODUCTION

The Commission services wish to continue discussions with the VAT Committee on the issues arising from the ruling of the Court of Justice of the European Union (CJEU) in the case C-7/13 *Skandia America*[1], in respect of the application of VAT grouping provisions, pursuant to Article 11 of the VAT Directive[2].

As said in previous meetings it is highly desirable, for the sake of legal certainty, to reach a common and consistent position on the consequences derived from that ruling.

2. BACKGROUND

The VAT Committee already had more than one occasion to discuss various issues arising from the *Skandia America* case[3], including whether the conclusions drawn by the CJEU are applicable in circumstances which differ from the facts of the case. The dispute in the case at hand revolved around the VAT treatment of supplies of services by a non-EU head office to its branch located in the EU, where that branch is part of a VAT group in a Member State which limits the admission to establishments (head office or branch) within its territory.

For that discussion, the Commission services had prepared a paper setting out their views[4]. Discussions were inconclusive, with some Member States finding it premature to draw a line under the matter. In parallel, the VAT Expert Group (VEG), a body set up to assist and to advise the Commission on VAT matters[5] had undertaken work on this subject and those Member States referred to that ongoing work.

3. FOLLOW-UP

Whilst the VAT Committee already examined the paper setting out the views of the Commission services (which remain valid), it is yet to hear the case made by business. To make up for that, it has been decided to transmit what is the outcome of the work undertaken by the VEG in regard to the *Skandia America* case.

Having identified *Skandia America* as a subject of particular interest, the VEG tasked a sub-group with looking at the issues raised by the ruling. A paper produced by the sub-group was endorsed by the VEG at its meeting on 11 September 2015.

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1 CJEU, judgment of 17 September 2014 in case C-7/13 *Skandia America Corporation USA, filial Svergie v. Skatteverket*

2 Council Directive 2006/112/EC of 28 November 2006 on the common system of value added tax (OJ L 347, 11.12.2006, p.1).

3 The discussion which commenced at the 102nd meeting was continued during the 103rd meeting of the VAT Committee.

4 Working paper No 845.

5 http://ec.europa.eu/taxation_customs/taxation/vat/key_documents/expert_group/index_en.htm

The paper, which can be found in annex[6], reflects the point of view of the experts appointed as members of the VEG and should not be taken as the position of the Commission services.

It is suggested to continue discussions on the implications of the *Skandia America* ruling, taking into account the initial analysis by the Commission services and the views expressed by the VEG.

4. DELEGATIONS' OPINION

Delegations are invited to express their views on the matters as initially raised. In particular, they are invited to consider the following questions:

Parties of the transaction

a) Whether *Skandia America* can be seen to have an impact on supplies other than "head office to branch".

Nature of the supplies

b) Whether apart from supplies of services, the doctrine established in the ruling would also apply to supplies of goods.

c) Whether the conclusions of the CJEU should only be applicable to bought-in supplies, or also to internally-generated supplies.

d) Whether *Skandia America* could have an impact on the allocation of costs between entities of the same legal person.

e) Whether it could have an impact on cost-sharing associations.

Territorial scope

f) Whether the doctrine established in *Skandia America* should be applicable to other scenarios other than "third countries to EU" supplies.

g) Whether the conclusion in *Skandia America* could have an impact on the place of supply.

VAT grouping provisions as applied

h) Whether the ruling could have an impact on businesses established in a Member State where the national VAT grouping provisions allow the membership in a VAT group of a related entity non-established in that Member State.

i) Whether the ruling could have an impact on businesses established in a Member State where the membership in a VAT group is automatic for entities falling within certain conditions.

[6] Available in English only.

j) Whether the ruling could have an impact in a Member State with anti-avoidance provisions.

k) Whether the ruling could have an impact on businesses established in a Member State which does not apply VAT grouping provisions.

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ANNEX

EUROPEAN COMMISSION
DIRECTORATE-GENERAL
TAXATION AND CUSTOMS UNION
Indirect Taxation and Tax administration
Value Added Tax

VAT Expert Group
11th meeting – 11 September 2015

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Brussels, 31 August 2015

VAT EXPERT GROUP

VEG N° 047

Sub-Group on the topics for discussion

VAT grouping and judgement in case C-7/13 (Skandia America Corp. (USA))

Contents

1. EXECUTIVE SUMMARY

The Skandia judgment has raised significant issues, which may potentially have impact way beyond the specific facts of the case. The discussions on the interpretation of Skandia ruling are currently high on the EU agenda, e.g. at the VAT Committee.

The sub group of the VAT Expert Group (VEG) was established with the remit to carry out an assessment of the Skandia case from a business perspective and provide its perspective and insights for the benefit of the broader ongoing EU deliberations. This working paper presents the findings of the Skandia assessment carried out by the subgroup and shall serve as a basis for further discussions in the full VEG. It is a working paper to start and stimulate discussions and help the VEG to agree on recommendations both for the Commission and Member States. In line with this, it should not be regarded as complete at this stage.

Regarding the scope of our assessment, we assessed the judgement itself as well as all areas that may be impacted should the tax authorities apply an extensive interpretation of Skandia. For carrying out the assessment we used a step by step methodology, preparing a number of transaction scenarios and assessing the impact against the fundamental principles of the EU VAT system, drawing then the results together to a higher level list of findings, which was eventually used for drawing our conclusions and preparing recommendations for the way forward.

The key points we would like draw out from our conclusions are:

(a) VAT grouping is of high importance for the EU economy and it provides significant benefits for both businesses and tax authorities (such as efficiency, transparency, better audit and risk management etc.). Therefore it’s important to protect the use of VAT grouping in the EU.

(b) There is a strong need for consistency in the application of the Skandia ruling.

(c) We firmly believe in a need for a limited interpretation of Skandia and prefer the broad application of FCE Bank principles, in order to protect fundamental principles of the EU VAT system. The main reasons are:

- protection of fiscal neutrality principle;
- respect of the territoriality principle and discretion of Member States in applying the VAT grouping regime; and
- avoidance of disproportionate administrative burdens for both businesses and tax authorities.

(d) In order to deal with the situations of non-taxation, we strongly recommend the use of (harmonised) anti-avoidance rules for the protection of the Member States’ revenues.

2. INTRODUCTION

In September 2014, the European Court of Justice (CJEU) ruled in the Skandia-case (nr. C-7/13[7]), a case with specific circumstances touching on the fundamental principles of the EU VAT system.

The CJEU ruled that taxable transactions were performed between the US-based head office and its fixed establishment, which was part of a VAT group in Sweden. Yet, based on previous cases of the CJEU, it was assumed by many (despite the fact that the Commission in its communication on VAT groups considered differently) that taxable transactions performed between the head office and the fixed establishment were not possible. The Skandia case instigated therefore discussions about the impact of transactions between a head office and a fixed establishment when one or both are members of a VAT group in an EU Member State.

The fundamental questions are – given the specific circumstances of the case and the specific Swedish implementation of Article 11 of the VAT Directive on VAT grouping – whether this case should have wider impact across the EU, and, if so, what the impact is both as regards to Member States that have implemented Article 11 of the VAT Directive and those who have not implemented this article in their national VAT laws.

The Skandia case, in particular the possible extension of the principles as stated by the CJEU to cross border supplies in the EU/non-EU, involving VAT groups established in other Member States than Sweden, has caused a lot of uncertainties on how businesses as well as authorities should deal with these issues.

Based on the discussions held at the VAT Expert Group (VEG) meeting in October 2014, the Commission services have set up a subgroup to assess the potential impacts of the Skandia case on fundamental VAT principles, as well as on business and tax authorities, and to reflect this in a working paper for a discussion at the VEG.

This working paper shall serve as a basis for further discussions at the VEG with the aim for the VEG to agree on recommendations for the Commission and Member States, which might prove helpful in the discussions that are currently taking place at the VAT Committee.

Assessment of the impact of Skandia

Scope

As mentioned above, the subgroup has been tasked with carrying out a comprehensive assessment on the potential impacts of the Skandia case on fundamental VAT principles, as well as on business and tax authorities.

The Skandia judgment raises different interlinked VAT issues for both businesses and tax authorities which are fundamental and where implementations and interpretations by Member States are diverging. These issues have been highlighted and dealt with in our working paper.

[7] ECJ 17 September 2014, C-7/13, Skandia America Corp. (USA), filial Sverige, www.curia.eu.

Methodology

In order to study all aspects of Skandia in depth, a step by step approach has been used. First of all the case itself and the specific circumstances around it were looked at. Subsequently multiple transaction scenarios were analysed in depth taking into account the VAT Directive, the case law of the CJEU, relevant literature, the Communication of the Commission on VAT Grouping[8] and the VAT Committee documents[9].

Finally we have drawn conclusions and made recommendations for a common interpretation and implementation by the Member States without overhauling the VAT system, whilst providing the required certainty to tax authorities and business.

The main report aims to provide a concise overview of our assessment, which is included in full detail in the six Annexes attached to the report. Therefore, the Annexes are the core part of the assessment, rather than just providing supporting information. We strongly recommend readers to review the Annexes in conjunction with the main report since only then the thorough thought process, the research done and the development of the findings, conclusions and recommendations of the sub-group become clear, which is important for a fruitful and productive discussions at the VEG.

3. BACKGROUND OF VAT GROUPING AND ITS ROLE IN THE EU

This chapter provides some essential background to the assessment of the Skandia ruling, looking at the relevant legislative provisions (mainly Article 11 of the VAT Directive[10]), its interpretation and importance in application across the EU and across different business sectors. A more detailed review of the background can be found in Annexes I and II.

3.1. VAT grouping in the EU VAT Directive: Article 11

The possibility of implementing VAT grouping in national legislation has existed since 1967 and is currently regulated in Article 11 of the VAT Directive, which provides Member States with an option (not an obligation) to implement a national VAT grouping regime.

Article 11 allows Member States to regard persons established in the territory of that Member State as a single taxable person, if they are legally independent but closely bound to one another by financial, economic and organisational links. Importantly, when exercising this option, a Member State can also adopt any measures needed to prevent tax evasion or avoidance through the use of VAT grouping.

The purpose of the provision on VAT grouping was to provide Member States with the possibility to treat several closely bound taxable persons as a single taxable person, if their

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8 Communication of the Commission to the Council and the European Parliament on the VAT Group option provided for in Article 11 of Council Directive 2006/112/EC of value added tax (COM(2009)325.

9 Sources used are referenced to in footnotes

10 Council Directive 2006/112/EC

independence is purely a legal technicality, for purposes of administrative simplification and combating abusive practices.[11]

It is important to note that although the Proposal for the Sixth VAT Directive[12] contained a specific additional provision aiming to treat some transactions between VAT group members as supplies for consideration[13], this provision was not adopted by the Council. This becomes relevant when defining the qualification of "transactions" as supplies following Skandia.

3.2. Comments on the Article 11 of the VAT Directive

The nature of Article 11 within the VAT Directive is very specific as it has some special features, which are essential for any assessment of Skandia and its impact. The features have been briefly covered below. Full comments including analysis of the relevant points in case law, can be found in Annex I.

The main specific features of Article 11 are as described in Annex I:

(a) Article 11 is an **optional provision** which gives Member States the freedom to introduce VAT grouping schemes in their national legislation or not. If not implemented, it will not be applicable in that Member State, as Article 11 has no direct effect. If a Member State adopts the provision, it has a significant margin of discretion over how to implement it. However, the court has set some specific parameters to it. VAT grouping therefore does not seem to be a European concept but is highly contingent upon national rules.

(b) VAT grouping arrangements are **a ‘fiction’** where a Member State may regard two or more closely bound persons established in that Member State, as a single taxable person for VAT purposes. Consequently, in the event of VAT grouping the member(s) of the VAT group are disconnecting themselves from their legal form and the way they do business commercially not only within the group but potentially also externally and become(s) part of a fictitious (taxable) person for VAT purposes.

(c) The third important feature of Article 11 is its **broad application regarding the notion of ‘persons’**, which includes also non-taxable persons. Member States can restrict the right to belong to a VAT group only “provided that they remain within the objectives of the VAT Directive to prevent abusive practices and behaviour or to combat tax evasion or tax avoidance”[14].

(d) The fourth important feature is the aspect of **territoriality** (linked to the principle of **fiscal neutrality**), as the members of a VAT group, the ‘persons’, should be established in the territory of that Member State, so cross-border groupings are not allowed. However,

[11] Communication from the Commission to the Council and the European Parliament on the VAT group option provided for in Article 11 of Council Directive 2006/112/EC on the common system of value added tax (COM(2009) 325), 2 July 2009, p. 3.

[12] Article 7(2)(b) of the Proposal for a Sixth Council Directive on the harmonization of Member States concerning turnover taxes Common system of value added tax: Uniform basis of assessment, COM(73) 950, 20 June 1973, see Annex I for the text of the proposed Article.

[13] Except where VAT on such supplies, were they to be supplied by another taxable person, would be wholly deductible.

[14] ECJ, C-108/14 (Larentia + Minerva), 16 July 2015, www.curia.eu, paragraph 41.

Member States have in general two types of approaches to the concept "to be established within the meaning of Article 11 of the VAT Directive":

- a broad interpretation, meaning that if a head office (or branch) is member of a VAT group within their territory, the foreign head office (or branch) is also considered as being a member of that VAT group. Applied e.g. by the UK and the Netherlands.

- a narrow interpretation implies that the foreign branch (or head office) cannot be member of the VAT group. Applied e.g. by Belgium, Sweden and Germany.

The EU Commission seems to follow the narrow interpretation[15]. However, the FCE Bank judgement seems to justify the broad approach. There are also other court cases dealing with the issue of territoriality[16].

(e) The last feature is the possibility for Member States to implement **anti-abuse measures**. Article 11 does not give further guidance on the specificities of such anti-abuse measures and the judgment of Larentia + Minerva also indicates that the discretion is general and considerable. With reference to the Skandia case, we note that Sweden is a country that has not yet made use of this discretionary power and freedom to implement such measures.

3.3. Use and importance of the EU VAT grouping provisions

Over the years VAT groups have gained importance in the EU. Seventeen Member States have by now – in different ways and forms – incorporated VAT grouping within their legislation, up from just thirteen Member states in 2006. More details can be found in Annex I, Section 3.

Regarding the uptake of VAT grouping within Member States, for example in Belgium, as of 20 August 2015, there were 2962 VAT groups, made up of a total of 9421 taxable persons, having on average 3 members in a group[17]. In Czech Republic, there are 216 VAT groups (approximately 30 in financial sector), having on average 4 members (approximate total of 864 companies). And a last example of Sweden, where as of May 2014 there were 153 VAT groups registered, 67 of which were non-financial businesses (including 36 groups of fully taxed businesses)[18]. There are no statistics on the number of VAT groups in all 17 Member States, however, there is no doubt that they are vast in numbers, considering the amounts in Belgium, Sweden and Czech Republic[19].

The existence of VAT grouping is economically very important. A non-published study on VAT and pan-European businesses showed that 15.6% of all cross-border trade within the EU comprised of transactions between multinational groups[20]. The intra-EU numbers represented 7.6% of the GNP of the EU-27, whilst 11.2% of the national trade in the

15 (COM(2009) 325) and VAT Committee wp no 856 on cost-sharing arrangements
16 Credit Lyonnais C-565/12, Welmory C-605/12, see Annex I, Section 2.
17 Belgian Cabinet response to the request of our subgroup
18 Lagradsremiss of 28 May 2014 "Vissa skattefragor infor budgetpropositionen for 201", p. 23.
19 The sub-group is attempting to gather more statistics on the use of VAT grouping from Member States.
20 PwC Study on VAT and Pan-European businesses, not published, p. 136-139, supervised by Ine Lejeune.

Member States would comprise of trade between linked companies worth 22.2% of the GNP.

Despite the lack of statistics, we are well aware based on our experience that VAT grouping has great importance for businesses across sectors and for tax authorities as well, since there are clear benefits for both business and tax authorities. As an example, when it comes to financial services, a study for the European Commission of 2006 showed the importance of VAT grouping for the financial and insurance sectors[21]. For this sector VAT groups help specifically to limit the impact of the 'cascade-effect' of non-deductible VAT on wages and profits and to improve the competitiveness with businesses outside the EU.

However, as mentioned, VAT grouping, where available, is widely used across many business sectors, including for example healthcare, or fully taxable sectors such as construction or consumer business, and across groups of all sizes (the average number of members in VAT group three in Belgium and four in Czech Republic).

The benefits of VAT grouping for both businesses and tax authorities are broad and include the following:

Efficiency: Less VAT returns have to be prepared, filed and paid by businesses and processed and checked by tax authorities. No invoicing requirements for intra-group transactions (in most Member States).

Audits: VAT grouping gives tax authorities a single point of audit with a clear picture and good overview of the legal entities that belong to a corporate group, allowing audits to be efficient and targeted.

Cash flow/refunds: Corporate groups are consisting often of a variety of legal entities, some in VAT payment position and others (particularly exporters) in refund position. VAT grouping regime allows consolidating the VAT payments of the legal entities, mitigating negative cash flow impacts for business and reducing the amount of refunds and related audits for tax authorities.

Risk management: The VAT grouping regime also helps corporate groups to manage VAT and the associated risks more efficiently for all the legal entities that belong to the corporate group by making it easier for them to implement consistent internal risk management procedures, which tax authorities have access to and can base their audits on. Thus also a benefit for tax authorities for their risk management. In addition, on the basis that intra-group transactions are ignored for VAT purposes, a VAT group is likely to make fewer errors – ie, a reduced number of VAT transactions should result in fewer mistakes being made in terms of VAT determination and accounting processes.

Joint and several liability: The VAT grouping regime gives tax authorities an additional financial security.

[21] "Study to increase the understanding of the economic effects of the VAT exemption for financial and insurance services", 2 November 2006, 22, http://ec.europa.eu/taxation_customs/resources/documents/common/publications/studies/financial_services_study_managementsummary_en.pdf, consulted on 31 July 2015.

Mitigating VAT Fraud: VAT grouping can help in mitigating VAT fraud (less VAT in the system which can be defrauded), as VAT grouping can be applied safely when combined with targeted anti-avoidance provisions (based on the existing EU best practices), providing benefits to the unpaid tax collectors, the business, while ensuring that the VAT revenues of the tax authorities are safeguarded – a large quantity of transactions can be taken out of the scope of the tax, potentially allowing resources to be reallocated to priority risk areas.

4. SKANDIA – ANALYSIS OF THE JUDGMENT AND ITS POTENTIAL IMPACT

This chapter provides an overview of the Skandia judgement. However, the CJEU has also ruled in several other judgements on the boundaries that Member States can or have to set to VAT grouping (more details can be found in Annex II)[22.] For the detailed analysis of the Skandia judgment, please see Annex III. The analysis also covers the potential impacts which the judgement could have on fundamental EU VAT principles. The opinion of the AG was not followed nor referred to by the Court in its judgement.

4.1. Analysis of the judgment

When analysing the Skandia judgment, it is important to recognise the facts and circumstances involved in the case, such as the questions asked and not asked (e.g. the existence of consideration) and the specifics of the Swedish VAT grouping regime (e.g. no anti-avoidance provisions), which have been further analysed in Annex III.

It is clear from how the judgment is worded that it is based on the facts of the case. Therefore, based on our analysis (see Annex III), we concluded that strictly speaking the Court did not rule on other situations, for example:

- when a branch makes “supplies” to a head office that is a member of VAT group;
- when services are internally produced and allocated to a head office or branch member of a VAT Group and not externally purchased;
- when only Member States are involved (and there is no establishment outside the EU);
- when goods are concerned; and
- whether cost allocations constitute consideration for services.

Moreover, we have concluded that the CJEU did not rule on a situation where the VAT grouping regime is of a different kind to that in Sweden. Actually, the Court explicitly limited its judgment to the specific kind of VAT groups present in Sweden (following the narrow approach) and the way Sweden has implemented Article 11 of the VAT Directive (without any anti-avoidance provisions).

The CJEU *did* rule on one, profound issue, namely whether there are supplies of services present in a situation such as that in the case in question. The answer was that the branch, by becoming a member of the VAT group, becomes part of the single taxable person/VAT

[22] FCE Bank (C-210/04); Larentia and Minerva/Marenave (C-108/14 and 109/14); Ampliscientifica (C-162/07) and infraction procedures by the European Commission (Nov 2009)

group, dissociating itself from its head office and therefore the transactions become supplies (for VAT purposes) made by the head office to the VAT group.

A key question when looking at the implications of the judgment is how far-reaching this fundamental stance by the Court is. Here, the Commission in its paper[23] takes a very broad view, e.g. that it applies equally to transactions in goods. However, we understand that Member States' tax authorities have taken different approaches towards the judgment. Some consider that the judgment applies in line with the Commission's analysis, some consider the case only concerns countries with VAT grouping regimes similar to the Swedish one whereas it is irrelevant for all other Member States.

In our view, the interpretation of the judgment should be looked at in the context of the EU VAT system and the principles upon which it is based, which formed also the basis for our assessment further described in the next Chapter.

Given the fact pattern at hand in the Skandia case and bearing in mind Sweden not having implemented anti-abuse provisions enabling taxation, the Court did with its decision preserve the integrity of the EU VAT system underlining that VAT on bought-in services, which are subject to VAT, is carried through the system and that taxation arises at the place of consumption. Therefore the Court ensured that the fundamental VAT principles are applied in the Skandia case, which means that the external services bought in by Skandia's head office in the US and used by other legal entities of the Skandia corporate group in Sweden – being members of Skandia's Swedish VAT Group – are taxed in Sweden.

We fully agree with the Court that the integrity of the VAT system needs to be preserved, that the fundamental VAT principles have to be applied to the Skandia fact pattern and the Swedish VAT legislation. Non-taxation of normally taxable IT services should not have occurred in the circumstances as set in Skandia.

It is, however, important to note that VAT should not arise on any "internal" costs incurred which do not carry any VAT (for example labour costs) and are passed on between legal entities of a corporate group which are members of the same VAT group, since "internal" consumption or value added within a single taxable person (be it within one legal entity or a VAT group) are generally not taxed under the VAT Directive. As indicated above the originally proposed provision to tax some intra-VAT-group supplies was never adopted. Instead, all "internal" operations or transactions that attract VAT are explicitly regulated in the VAT Directive (such as deemed supplies).

A fortiori, taxation of transactions between a branch and its head office, not being legally and economically independent and not being provided under the Directive, even where one of them belongs to a VAT Group, constitutes an exception to the fundamental principles of the VAT system.

Therefore, taxation may only be justified in very specific circumstances (e.g. similar to Skandia)[24]. Even where taxed, the taxation ought to be carried out without creating disproportionate compliance obligations for businesses, particularly for businesses which

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23 European Commission, Working paper n°845, Taxud.C.1(2015)747072, p. 19 and 25.

24 Important to note, that even the Skandia judgement was conditional, as the Court concluded: "Inasmuch as the services are provided for consideration.."

are fully entitled to deduct input VAT. It is also important that the taxation does not hinder commerce, ensures the neutrality of taxation (particularly for the exempt sector) and is carried out without compromising the Common VAT System as laid down in the VAT Directive.

There are systems in other parts of the world, which manage well the compliance costs in similar circumstances, e.g. for businesses which are fully entitled to deduct input VAT, and which also try to mitigate the creation of new "artificial" VAT costs (VAT on internal labour elements). Such measures could therefore also be taken into consideration.

4.2. Potential impact of Skandia on the principles of the EU VAT Directive

As mentioned in the above analysis, the Skandia judgement may potentially have a wide ranging impact on the transactions between the head office and branch (or even between branches), depending on how widely the judgement can and should be interpreted. Therefore, it is important to analyse to what extent the implementation of the CJEU ruling impacts and/or may overrule the basic principles laid down in the VAT directive (for full analysis see Annex III).

As we see it, the judgement raises the following questions and concerns regarding potential impacts, further assessed in the following Chapter:

1. Impact on basic principles of the VAT Directive

(a) <u>Principle of territoriality</u>: a wide application of Skandia raises a risk that principles of territoriality and sovereignty will be overruled/limited. Indeed, under this interpretation Member States are obliged to respect VAT rules regarding VAT grouping in other Member States, even if they have not introduced VAT grouping schemes themselves.

(b) <u>Supply 'for consideration'</u>: by considering the internal transactions as taxable supplies, it becomes necessary to determine the consideration/taxable amount of such transactions. This may create significant challenges, as in case of internal transactions there may be no link between the transaction and a consideration/cost allocation and transfer pricing rules may not help as these are based on different principles than VAT.

(c) <u>Risk of (indirect) double taxation and unintended non-taxation</u>: different interpretations of Skandia may create double taxation where the transaction is taxed by the Member State of the recipient but the related input tax is blocked by the Member State of the supplier, as they would not consider this transaction taxable. The reverse is also true so that the supplier's Member State may treat the transaction as taxable (outside the scope with recovery) but the Member State of the receiver may treat the transaction as VAT exempt.

(d) <u>Breach of fiscal neutrality principle</u>: the neutrality principle of treating same transactions equally may be breached, if the treatment of internal transactions to one branch would be taxable (when part of VAT group – Skandia), but to a branch in another Member State treated as out of scope (not in a VAT group – FCE Bank)

(e) <u>Internally generated supplies</u>: the Skandia case was about taxation of externally purchased services, however the question arises whether it applies also to internally generated supplies, the taxation of which would increase the VAT costs for companies and potentially make EU businesses less competitive versus their foreign rivals. It is important to emphasise that under either a wide or a narrow approach internal labour costs should not be taxed.

2. Scope of application of Skandia

(a) Head office – branch transactions: interpretations of the ruling differ regarding whether the ruling applies also to branch to head office and/or branch to branch situations and whether it matters that a branch or head office is outside EU. Also as mentioned above, there is a risk that it may be extended to internally generated supplies.

(b) Supply of goods and other services: the ruling may have impact on other services (e.g. taxed under a special place of supply rule, such as Art 47) or on transactions of goods.

3. Impact on compliance

Potential practical compliance issues would include the need for a supplier/a customer to know whether the customer/supplier is a member of a VAT group (which would influence invoicing and reporting), which type of VAT group it belongs to and so on. Thus the VAT ruling would start to impact commercial reality, which should not be the case. The supplier/customer should not need to know this information from its customer/supplier.

5. FINDINGS OF THE IMPACT ASSESSMENT OF SKANDIA

The identified questions and potential problems covered in the previous Chapter were taken as a basis for our detailed assessment of the impact of Skandia. This Chapter provides an overview of the findings of the assessment and the detailed assessment can be found in Annexes IV–VI.

5.1. Criteria and methodology for assessment

Criteria

In the impact assessment a set of criteria has been used, a combination of the criteria from a tax authority's perspective and criteria from taxable person's perspective, illustrated in the diagram below.

From a Tax Authority's perspective				*From a Taxable Person's perspective (customer and supplier)*			
Budgetary impact		*Ease of administration and cost of collection*	*Prevention of fraud and abuse*	*OECD principles*		*Cost of implementation and compliance*	*Budgetary impact*
Cash flow	*Revenue*			*Legal certainty and simplicity*	*Neutrality*		

- = negative impact on cash flow	*- = loss of VAT income*	*- = additional effort costs likely*	*- = not resistant to existing types of fraud*	*- = less certainty and simplicity*	*- = less neutrality*	*- = negative impact on cash flow*	*- = increase costs*

Methodology

In our view, the interpretation of the judgment should be looked at in the context of the EU VAT System and the principles upon which it is based. Therefore the analysis was done applying EU VAT principles as well as the predetermined assessment criteria to seven different transaction scenarios, consisting of two basic scenarios on services and five specific scenarios.

The **two basic scenarios** cover:

- Scenario 1: Head office is not part of a VAT group in supplier's country
- Scenario 2:Head office is part of a VAT group in supplier's country

The **five specific scenarios** cover:

- Scenario 3: Real estate services from one member of a VAT group to another member
- Scenario 4: Transaction from non-EU branch to other branch which is member of a VAT Group in recipient's country
- Scenario 5: Transactions of goods
- Scenario 6: Re-invoicing to third parties
- Scenario 7: Reallocation of costs / Cost sharing

5.2. Findings of the assessment

5.2.1. Article 2 – Scope of VAT

Head office to branch transactions: taxable or out of scope

As described above, when it comes to VAT grouping, there is a mismatch between two different approaches to transactions between legal entities/branches of a corporate group that are members of the same VAT group (intra-company transactions): the broad and the narrow approach. Application of the broad approach treats these transactions as out of scope, whilst these become taxable in the narrow approach.

As proven by the assessment (all scenarios are impacted), such a mismatch between a broad and a narrow approach has the following impacts:

Tax authority's perspective

- distortion of territoriality and subsidiarity principles, as a Member State (of a head office) has to adjust its national legislation to apply Skandia principles

- high cost of administration due to the increased complexity of rules on VAT grouping and an obligation to take into account the implementation of Article 11 in other Member States

- potential increase in tax avoidance due to mismatches between national regimes and complexity of tax audits

Business perspective

- distortion of neutrality principle, as business needs to apply a different treatment to its intra-company transactions, depending on whether the branch in another Member State belongs to a VAT group and whether that other Member State applies a broad or a narrow approach to VAT grouping.

- high compliance costs due to multiple and diverging treatment of internal supplies

- potential budgetary impact as businesses may not be able to deduct input VAT on the "supplier" side despite applying VAT on internal supplies from the "recipient" side

5.2.2. Taxable persons

Head office to branch transactions: one or two taxable persons

The two approaches also create a mismatch regarding the definition of taxable person. A broad approach treats the head office and branch as a one taxable person (FCE Bank), whilst the narrow approach separates them into two taxable persons (Skandia).

Tax authority perspective

- Same as in 4.2.1.

- Different aspects of this impact have been brought out in following points (registration, liability etc.)

Taxable person perspective

- Same as in 4.2.1

- Different aspects of this impact have been brought out in following points (registration, liability etc.)

5.2.3. Taxable transactions (services and goods, self-supplies)

Skandia dealt with externally bought services. The extension of its application to goods or internally generated supplies would have significant impact on businesses and tax authorities.

Tax authority perspective

- Budgetary impact due to potential impact on place of supply (see 4.2.4.)
- Increased enforcement and administrative costs from complex compliance control (e.g. regarding taxation of internal supplies)

Taxable person perspective

- Regarding internal supplies:
- Budgetary impact from taxation of labour costs
- Increased compliance costs and difficulties regarding identifying the consideration
- Regarding goods and other services:
- Potential impact on liability and compliance requirements if place of supply is impacted as a consequence of extension to goods or other services (see 4.2.4.)
- Impact on importation process: confusion over who is the importer

5.2.4. Place of taxable transactions (impact on special PoS rules)

Extending Skandia to other services and goods may cause place of supply issues and related issues with taxing rights and business liability (see Scenarios 3 and 5).

Tax authority perspective

- Budgetary impact: taxation rights of a Member State where supply takes place due to a special place of supply rule (e.g. Art 47) may be impacted.
- Impact on taxation rights when goods are located in a Member State other than the head office or branch/VAT group: is it a taxable transaction or out of scope?
- Impact on application of triangulation rules

Taxable person perspective

- Confusion on who is required to register in a Member State where supply takes place (Art 47 or Art 31 and 32) – head office or VAT group (including branch)
- Risk of multiple VAT registrations of the same entity

5.2.5. Taxable amount (consideration issues)

Even in the specific situation in Skandia the intra-company transactions could be taxed only where there was a consideration. However, determining the existence of direct consideration and correct taxable amount will be challenging for businesses.

Tax authority perspective

- Budgetary impact: lack of clarity on taxable amount will impact the collectible VAT. A risk of loss in revenue regarding internal transfers with no consideration[25].

- Increase in administrative burden due to complexity in auditing of taxable amount and pricing of intra-company transactions

Taxable person perspective

- Increase in compliance cost due to complexity of determining the taxable amount on inter-company supplies, as the existing cost allocation and transfer pricing arrangements may often not be appropriate

- Potential budgetary impact where business is obliged (by national rules) to determine the taxable amount of internal supplies where by commercial reality there would be no consideration, especially e.g. taxation of labour costs

5.2.6. VAT rates and exemptions

The implementation of Skandia makes intra-company transactions taxable, which therefore makes them also subject to the VAT rate and exemption regime in the Member State of the branch or head office/VAT group. This may impact the right to input VAT deduction of the head office or the branch (see point 4.2.8.)

5.2.7. Liability

Several potential impacts of Skandia on the liability for businesses to register for VAT and account for VAT have been identified above, e.g. in relation to any place of supply impact or extension to goods (including the impact on import liabilities) and other services.

5.2.8. VAT deductions

Taxation of intra-company transactions may have an impact on the right of deduction of the head office. The mismatch between the broad and the narrow approaches in Member States where the head office and branch/VAT group are located, may create (in)direct double taxation (see scenario 1.3) or non-taxation (see scenario 1.2).

The combination with the implementation of the Credit Lyonnais judgment may also cause indirect double taxation, as the transaction is taxed on the recipient's side but the related input tax has to be disregarded for the head office's partial exemption purposes.

5.2.9. Allocation of costs

The Court has not analysed the impact of allocating costs in Skandia. It would be farfetched to draw such conclusions from the judgment. The allocation of costs can only be in the scope of VAT if further to Article 2(1)(c) of the VAT Directive:

[25] Even Article 80 of the VAT Directive (anti-avoidance measures for determination of taxable amount) requires there to be a consideration paid in the first place

- it concerns a supply between two taxable persons and
- it is made for consideration.

Even when it would concern two taxable persons (e.g. as in Skandia) there must be consideration before any allocation of costs can be within the scope of VAT.

5.2.10. Compliance requirements

A wide implementation of Skandia may have an impact on business' compliance requirements, such as on registration (see 4.2.4.) and on invoicing and reporting of taxable inter-company transactions.

6. CONCLUSIONS

As can be seen from the findings described in the previous Chapter, the application of the Skandia case raises important issues and could lead to significant difficulties.

Consistency

The assessment raises a key question: is consistency of approach feasible? Not just in terms of implementing the judgement but more fundamentally in terms of implementing VAT grouping arrangements as per Article 11 and reconciling the narrow and broad territorial interpretations. The discretion of Member States when implementing Article 11 in terms of anti-abuse measures will help mitigate the anomalies identified. It is open to Member States to adopt such measures to prevent anomalous positions arising.

Fundamental to a consistent or uniform approach across the various Member States (as envisaged in the Commission paper to the VAT Committee of February 2015) is that every Member State would have to recognise a VAT group arrangement that has been implemented in other EU Member States, even where the Member State itself has not implemented a VAT grouping arrangement. Without that consistency of approach and in particular the mutual recognition of VAT groups across the EU (as independent discrete taxable persons and that branches of legal entities headquartered elsewhere are "dissociated" for VAT purposes), our assessment illustrated the challenges that may be present in practice and which could lead to potential distortions and anomalies in the functioning of the VAT system.

Risks of extended application

Regarding the scope of Skandia and its potential wide impact, we concluded that first of all, the extended application of the Skandia case could lead to <u>conflicts with the fundamental principles of the VAT Directive</u>. For example, the VAT Directive has specific regulations for the taxation of internal supplies. These provisions are sometimes mandatory (e.g. fictitious intra-Community acquisitions and supplies of goods) and sometimes voluntary (as regards services (Article 27) or goods (Article 18)). If Skandia is broadly applied, these provisions will to a certain extent be redundant.

Furthermore, the territorial scope of the right to deduct, as interpreted by the Court, would also be significantly circumscribed if other Member States' legislation on VAT grouping determines the right to deduct in the Member State of establishment. The principles of territoriality and sovereignty would be compromised.

A broad application of Skandia does not necessarily lead to the desired result, taxation at the place of destination. Here we stress the importance of the concept of "consideration" of the VAT Directive. As a profit (or cost) allocation can usually hardly be seen as consideration, there will be situations of non-taxation and of taxation, purely based on what internal regimes and principles are applied within a company. This is hardly conforming to the overall purposes of the VAT directive, especially to neutral taxation of consumption at the place of destination.

The application of the Skandia principles can also lead to situations of double taxation, as one Member State where the transactions takes place will consider the transaction as taxable, but the other relevant Member State refuses the right of deduction of the supplier, if the transaction is not taxable according to its national point of view. The reverse is also true so that unintended non-taxation may occur where the supplier's Member State treats the transaction as taxable (outside the scope with recovery) but the Member State of the receiver treats the transaction as VAT exempt.

More generally, such Skandia principles could be in conflict with the principle of fiscal neutrality.

For example, based on Skandia principles, internally generated services could become taxable, which would increase VAT costs for some groups of companies. This is in conflict with VAT being neutral to how taxable persons organize their business. Additionally, it will also increase compliance obligations for businesses that are fully entitled to input VAT recovery.

The broad application of the Skandia judgement also results in practical complications and difficulties as regards the place of supply provisions.

As the CJEU has ruled in the Skandia case on specific facts and specific Swedish circumstances (i.e. Article 11 of the VAT Directive was implemented without any anti-avoidance provisions), it is still uncertain whether the principles which can be derived from that court case, could or should be applied to other situations. Especially considering the impact on fundamental VAT concepts and principles if it is applied extensively, we hesitate to consider that the Court intended such a broad application.

Based on the above considerations, we are not in favour of a broad interpretation of Skandia, but firmly believe in the need to limit it to the facts of the case[26]. That means, applying to a situation with a third country involved, regarding a VAT group in a country following a narrow territorial scope, limited to transactions involving services and excluding the taxation of internal cost elements such as labour cost. Instead, we recommend broad application of the FCE Bank principles, considering most intra-company transactions as out of scope of VAT.

[26] See, by analogy, CJEU 25 October 2012, joined cases C-318/11 and C-319/11, Daimler and Widex, EU:C-2012:666, paras. 45 et seq., regarding the need to apply the DFDS judgement only in the context of that particular case

A solution – anti avoidance rules

In order to deal with situations of non-taxation, anti-avoidance provisions could be introduced in all Member States which have VAT grouping provisions based on Article 11. We find the benchmark of the UK anti-avoidance rules[27] as one useful way of achieving a correct outcome – where the services acquired externally are onward supplied, they should be considered a taxable supply in so far as the VAT group has a limited right to deduct input VAT. This would be in accordance with the purpose of the proposed provision for taxation of internal supplies in VAT Groups which was never adopted in the end 1970s.

As regards to countries where there is no VAT grouping available, the legal basis for anti-avoidance provisions may be Article 273 of the VAT Directive, allowing Member States to impose (in certain circumstances) additional obligations on taxable persons in order to prevent tax evasion.

Lastly, with regard to the right to deduct input VAT in countries which are not applying a VAT grouping regime, we note that these countries have a possibility to introduce Article 27 for taxation of internal supplies, if deemed necessary. So as a result, the "supplies of services" made to a foreign head office (or branch) could be considered as supplies for consideration, in so far as the foreign head office (or branch) is a member of a VAT group in a country applying a narrow territorial scope. However, introduction of such rules should not impose new compliance obligations for businesses who can fully deduct input VAT or hinder commerce and should ensure the neutrality of taxation (particularly for the exempt sector). International best practices may be worth considering for an effective mitigation of any "artificial" VAT cost (VAT on internal labour elements).

7. RECOMMENDATIONS AND SUGGESTED WAY FORWARD

Based on the conclusions drawn from the detailed assessment of the impact of Skandia, the sub-group makes the following recommendations for the implementation of the Skandia judgment, to be explored and discussed further at the VEG:

- The importance of VAT grouping to the EU economy and single market should be recognised and should not be jeopardised. Therefore Member States should ensure that the implementation of Skandia judgment does not hinder the role of VAT grouping in the EU and should secure the benefits what VAT grouping has for both business and tax authorities.

- The Skandia judgment should be applied only in the context of the case, and so applied only to:

  (i) transactions involving non-EU head offices or branches;

  (ii) VAT groups in the Member State with a narrow approach to territorial scope;

  (iii) the Member State of the VAT group that has not implemented anti-avoidance rules and

[27] Disregarding the impact of the recent HMRC decision regarding the application of Skandia judgment

(iv) transactions involving externally bought services.

- Member States applying VAT grouping regimes should be urged to introduce anti-avoidance and anti-abuse measures to deal with situations of non-taxation. In order to provide for consistency, it is recommended that Member States apply "common" anti-avoidance provisions, which could be based on the one applied by the UK (or by Belgium until its withdrawal).

- Should the recommendations above not be acceptable to the Member States, consideration could be given to an alternative longer term solution to the situation: a change to the VAT Directive to make transactions between head office and branch taxable. However, in this case it is important to respect the neutrality principle, ensure a clear view of what constitutes consideration for a supply, avoid tax cascading (e.g. on labour costs) and avoid creating new compliance burden particularly for businesses who are fully entitled to deduct input VAT. Finally, the more work is done on exploring whether the tax base can be broadened (e.g. by abolishing some VAT exemptions), the less we need to worry about and resolve issues that violate the neutrality principle.

8. RESPONSE TO THE VAT COMMITTEE WORKING PAPER NO 845

In the last part of our report we have drawn parallels between our and Commission's assessment of the Skandia judgement by providing answers to the questions raised at the Commission's VAT Committee working paper no 845 of 17 February 2015.

Commission's questions	**Task team responses**
Parties of the transaction	
a) Whether Skandia America can be seen to have an impact on supplies other than "head office to branch".	It could be applied also to 'branch to head office' and 'branch to branch' supplies (as the relations are similar), but it is not relevant to 'parent to subsidiary' supplies
Nature of the supplies	
b) Whether apart from supplies of services, the doctrine established in the ruling would also apply to supplies of goods.	It should not be applied to supplies of goods
c) Whether the conclusions of the CJEU should only be applicable to bought-in supplies, or also to internally-generated supplies.	It should be applied only to bought-in supplies
d) Whether Skandia America could have an impact on the allocation of costs between entities of the same legal person.	Generally not, only in (limited) cases where there is legal relationship with reciprocal performance and the allocation of cost can be considered a consideration for 'supply'

e) Whether it could have an impact on cost-sharing associations.	Yes, but only in specific Skandia circumstances (as in our recommendations)
Territorial scope	
f) Whether the doctrine established in Skandia America should be applicable to other scenarios other than "third countries to EU" supplies.	Despite the fact that we see no reason in the VAT Directive to limit the reach of Skandia America in this regard, we note that the application to intra-EU situations creates issues which were not properly addressed in the Skandia case concerning conformity with the TFEU and particularly the freedom of establishment.
g) Whether the conclusion in *Skandia America* could have an impact on the place of supply.	Any impact to place of supply should be avoided
VAT grouping provisions as applied	
h) Whether the ruling could have an impact on businesses established in a Member State where the national VAT grouping provisions allow the membership in a VAT group of a related entity non-established in that Member State.	It should not impact businesses (i.e. it does not apply) in countries with broad approach to territoriality
i) Whether it could have an impact on businesses established in a Member State where the membership in a VAT group is automatic for entities falling within certain conditions.	It should not have an impact (i.e. it should not apply), as businesses have no choice regarding being a Member of a VAT group
j) Whether it could have an impact in a Member State with anti-avoidance provisions.	It should not apply in countries which have effective anti-avoidance provisions
k) Whether the ruling could have an impact on businesses established in a Member State which does not apply VAT grouping provisions.	It should not impact businesses (i.e. it does not apply) in countries with no VAT grouping

ANNEX I – VAT GROUPING IN THE EU

1. The VAT group within the EU VAT Directive: Article 11 of the VAT Directive

The possibility of implementing the VAT group in national legislation has existed since the second Directive of 11 April 1967[28] – although it was initially not proposed by the Commission – and still exists in the current Directive 2006/112/EC[29]. Prior to its inclusion in the European legislation the Netherlands had already developed the concept of the VAT group in 1934.The Netherlands included the VAT group in its 1968 VAT Law. Germany also introduced the concept of an '*Organschaft*', closely related to a VAT group, before the implementation of the Sixth Directive.

The purpose of the provision on VAT grouping was to provide Member States with the possibility to treat several taxable persons as a single taxable person, when they are closely bound to each other by financial, economic and organisational links and whose independence is purely a legal technicality for purposes of administrative simplification or combating abusive practices[30].

It is important to note that in the Proposal for the Sixth VAT Directive a specific Article was introduced regarding self-supplies of services by VAT groups. It reads as follows:

> *"Article 7 Supply of Services*
>
> *1. (...)*
>
> *2. The following shall be treated as supplies of services for consideration:*
>
> *(a) (...)*
>
> *(b) the supply of services as between persons considered to be a single taxable person within the meaning of the second subparagraph of Article 4(4), save where the value-added tax on such services, were they to be supplied by another taxable person, would be wholly deductible."*

This deeming provision was not adopted which is important to bear in mind when defining the qualification of "transactions" as supplies following Skandia[31].

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28 Article 2, § 4, Council Directive no. 67/228, 11 April 1967 on the harmonization of legislation of Member State concerning turnover taxes (Second VAT Directive). Article 2 of the proposal for a second Directive for the harmonization among Member States of turnover tax legislation, concerning the form and methods of application of the common system of taxation on value added, COM(65) 144 final, 13 April 1965, Supplement to the Bulletin of the European Economic Community No. 5, 1965, pages 26-35. See also ioined Cases 181/78 B.V., Wateringen (Netherlands) and Staatssecretaris van Financiën and Case 229/78 between Minister van Financiën and Denkavit Dienstbetoon B.V.

29 Article 11, § 1, Council Directive 2006/112/EC, 28 November 2006 on the harmonization of legislation of Member State concerning turnover taxes.

30 Communication from the Commission to the Council and the European Parliament on the VAT group option provided for in Article 11 of Council Directive 2006/112/EC on the common system of value added tax (COM(2009) 325), 2 July 2009, p. 3.

31 Proposal for a sixth Council Directive on the harmonization of Member States concerning turnover taxes Common system of value added tax: Uniform basis of assessment, COM(73) 950, 20 June 1973.

Article 11 of Directive 2006/112/EC allows Member States to regard persons established in the territory of that Member State as a single taxable person if they are legally independent but closely bound to one another by financial, economic and organisational links. Member States are not obliged to implement VAT grouping.

> *Article 11 of Directive 2006/112/EC:*
> *"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.*
>
> *A Member State exercising the option provided for in the first paragraph, may adopt any measures needed to prevent tax evasion or avoidance through the use of this provision".*

The VAT Implementing Regulation does not have any provisions regarding VAT Grouping[32].

2. Comments on Article 11 of the VAT Directive

The nature of article 11 within the VAT Directive is very specific as it has some special features. Note that Article 11 is the only provision in the VAT Directive which refers to VAT grouping schemes.

First of all, Article 11 is an optional provision which gives Member States the freedom to introduce VAT grouping schemes in their national legislation or not. So if a Member State choose not to take up the option provided by Article 11, it will not be applicable in that Member State's territory in accordance with its implementation of the VAT system.

A provision of a directive has direct effect allowing taxable persons to claim the benefit thereof against their Member State, to the extent the provision is unconditional and sufficiently precise, it may be relied upon before the national courts by individuals against the State where the latter has failed to implement the directive in domestic law by the end of the period prescribed or where it has failed to implement the directive correctly[33].

It was recently confirmed by the CJEU in the Larentia + Minerva case[34] that this was not the case for Article 4(4) of the Sixth Directive (current Article 11 of the VAT Directive) as this article is conditional: as Member States are free to implement or not implement Article 11, it cannot be imposed on them by taxable persons (and a *fortiori* not by other Member States). Where a Member State opts to introduce VAT Grouping, the formation of a VAT group is subject to the existence of close financial, economic and organisational links between the persons concerned and the detailed conditions need to be specified at national level. The Court concluded from this that the provision cannot have direct effect.

Where a Member State opts to implement VAT grouping, Article 11 seems to provide a significant freedom to the Member States to implement it into national legislation in their

[32] Council Implementing Regulation (EU) No 282/2011 of 15 March 2011 laying down implementing measures for Directive 2006/112/EC on the common system of value added tax

[33] ECJ, C‑589/12 (GMAC UK), 3 September 2014, www.curia.eu, paragraph 29.

[34] ECJ, C-108/14 (Larentia + Minerva), 16 July 2015, www.curia.eu, paragraph 46-51.

own way and lay down detailed national rules. The Court has ruled that the wording of the provision sets out limits with regard to the level of Member States' discretion.

For example, the "persons" that are members of a VAT group can also include non-taxable persons.[35] Also, the effect of a VAT group is that no taxable transactions are present between the members of the group and the group now acts as the "single" taxable person (as can be seen from the judgment in Ampliscientifica. As the European Commission has noted in their Communication[36] in the event a Member State has opted to implement Article 11, this implementation should be seen as a particular national deviation on the normal rules.

The CJEU has confirmed in the Larentia + Minerva case that the Member States, in the context of their margin of discretion, are entitled to make the application of the VAT group scheme subject to certain restrictions provided that they fall within the objectives of the VAT Directive to prevent abusive practices and behaviour or to combat tax evasion or tax avoidance[37].

We note that the margin of discretion will inevitably result in different types of VAT grouping regimes in the various Member States. VAT grouping seems not to be a European concept but highly contingent upon national rules.

A **second feature** of Article 11 is that VAT grouping schemes are a 'fiction' where a Member State may regard two or more persons established in that Member State who, while legally independent, are closely bound to one another (by financial, economic and organizational links), as a single taxable person for VAT purposes – but only for VAT purposes. Consequently, in the event of VAT grouping the member(s) of the VAT group are disconnecting themselves from their legal form and the way they do business commercially and become(s) part of a fictitious (taxable) person for VAT purposes.

The **third important feature** of Article 11 is its broad application regarding the notion of 'persons'. As already stated above, Member States can restrict the application of Article 11 "provided that they remain within the objectives of the VAT Directive to prevent abusive practices and behaviour or to combat tax evasion or tax avoidance"[38]. As a consequence, this leads to divergences between the Member States.

This leads us to the **fourth important feature** of Article 11, namely the aspect of territoriality, as the VAT grouping schemes require that the members of a VAT group, the 'persons', should be established in the territory of that Member State.

With respect to the concept "to be established within the meaning of Article 11 of the VAT Directive" one can distinguish in general two types of approaches:

- On the one hand, there are Member States with a broad interpretation of this concept and which are of the opinion that if a branch (or head office) is member of a VAT group within their territory, the foreign head office (or branch) of this branch (or head office) is also considered as being member of that VAT group. Member States which

35 See the outline of the case law below
36 COM(2009) 325
37 ECJ, C 480/10, (Commission v Sweden), 25 April 2013, www.curia.eu, paragraphs 38 and 39.
38 ECJ, C-108/14 (Larentia + Minerva), 16 July 2015, www.curia.eu, paragraph 41.

follow this broad interpretation are amongst others the United Kingdom and the Netherlands.

- On the other hand, a narrow interpretation implies that the foreign branch (or head office) cannot be member of the VAT group. For instance, Belgium, Sweden and Germany follow this narrow approach.

The narrow interpretation seems to be in line with the Communication on VAT Grouping provided in Article 11 of the VAT Directive of the European Commission[39]. The European Commission stated since VAT grouping is optional for each Member State, it should not have the effect of extending beyond the physical territory of the Member State which has introduced it and may not infringe the fiscal sovereignty of another Member State. The European Commission consequently concluded that fixed establishments situated abroad are excluded from a VAT group which is established in another Member State.

According to the European Commission in Working Paper N° 845[40], a justification of the broad interpretation could be found in the conclusions of the FCE Bank case of the ECJ, in which it was stated that a branch and its head office form the same legal entity and should be treated as one single taxable person for VAT purposes. We note that the Commission’s view is disputed by academics unless the branch has "endowment" capital allowing it to run economic risks[41].

In this respect the case law of the CJEU on the interpretation of the VAT Directive should also be borne in mind as expressed in the Welmory case:

> *"41 It should be recalled that, when interpreting a provision of EU law, is necessary to consider not only the wording of the provision but also the context in which it occurs and the objective pursued by the rules of which it forms part (judgment in ADV Allround, C‑218/10, EU:C:2012:35, paragraph 26 and the case-law cited).*
>
> *42 In accordance with settled case-law of the Court, the object of the provisions determining the point of reference for tax purposes of supplies of services is to avoid, first, conflicts of jurisdiction which may result in double taxation and, secondly, non-taxation (see, to that effect, judgment in ADV Allround, EU:C:2012:35, paragraph 27 and the case-law cited)."*

In this same judgement the Court also stresses the need to respect the territoriality principle, when defining the place of taxation and the discretion of the Member States to levy the tax, as follows:

> *"50 In this connection, it must be recalled, as is apparent from paragraph 42 above, that a provision such as Article 44 of the VAT Directive is a rule determining the place of taxation of supplies of services by designating the point of reference for tax purposes, and consequently delimiting the competences of the Member States.*

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39 (COM(2009) 325)

40 European Commission, Working paper n°845, taxud.c.1(2015)747072; See also Commission vs Ireland, https://circabc.europa.eu.

41 See further: Ad Van Doesum and Gert-Jan Van Norden “T(w)o become one: the communication from the Commission on VAT grouping”, British Tax Review, 2009 Number 6, page 657

> *51 For that purpose, that provision aims to create a rational delimitation of the respective areas covered by national rules on VAT by determining in a uniform manner the point of reference for tax purposes of supplies of services*[42].

Respecting territoriality is also important in order to respect the principles of fiscal neutrality, one of the basic principles of the VAT Directive and the VAT system. The freedom to implement detailed national rules and any application/interpretation of the Directive may not harm the principle of fiscal neutrality in the case of cross border transactions.

It should be noted that in the VAT Directive, the territorial application of Article 11 is confined to the Member State that has chosen to implement VAT grouping. Cross border grouping is not provided for nor does the Directive provide that the decision to implement grouping by one Member State and the consequences thereof can be imposed and extend to another Member State which has decided not to introduce VAT grouping in its national VAT rules[43].

The legal situation as regards branches and head offices and VAT groups and the impact on other Member States is not completely clear. Yet, it seems that Member States have a right to determine the rules applicable to establishments within their territory and that other Member States' legislation cannot have an impact on those rights.

In the Credit Lyonnais judgment, the Court ruled that only the Member State where an establishment is situated should be able to determine the deductible proportion and that therefore the turnover of establishments outside that Member State could not be taken into consideration.

The Court explicitly referred to Article 27 of the VAT Directive in this context and stated that if a Member State would like to take into account transactions between the branch in the Member State and its head office outside that Member State, it may tax the internal transaction[44]. This indicates that the Member State where the branch is established should have the possibility to determine the transactions providing for the right to deduct and that this should not be dependent upon decisions taken by another Member State.

In the context of VAT Grouping, this implies that only the Member State where the establishment is should be able to determine the scope of the right to deduct, and this right should not be dependent upon decisions (VAT Grouping provisions) of other Member States. Article 169(a) also indicates that the rules in (and choices made by) the Member State where the establishment is should determine the right to deduct. If a transaction is performed outside, the right to deduct exists in so far as deduction would be allowed, if the transaction had been performed within the Member State. This indicates that the Member State where the establishment is has the right to determine the existence of any right to deduct VAT.

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[42] Case C- 605/12, Welmory, 16 October 2014

[43] Credit Lyonnais C-565/12, Welmory C-605/12,Working paper no 856, VAT Committee 6 May 2015 prepared by the Commission on the scope of the exemption for cost-sharing arrangements: a further analysis, page 13 refers to the fact that Article 11 of the VAT Directive explicitly limits the scope of application to the territory of the Member State of establishment.

[44] Credit Lyonnais C-565/12, paragraph 39

The **last feature** of Article 11 is the possibility provided by paragraph 2 for Member States to implement anti-abuse measures. Article 11 does not give further guidance to the specificities of such anti-abuse measures. The judgment of Larentia + Minerva also indicates that the discretion is general and considerable. Consequently, Member States have the freedom to implement such measures and if they do, they have the discretionary power and freedom to implement the anti-abuse measures which suit them best. A side effect of this lead once again to many differences between Member States. With reference to the Skandia case, we note that Sweden is a country that did not make use of this discretionary power and freedom to implement such measures.

3. Some statistics on the number of VAT groups and business groups in the EU

AT	BE	BG	CY	CZ	DK	EE	FI	FR	DE	EL	HU	HR	IE	IT	LV	LT	LU	MT	NL	PL	PT	RO	SK	SL	ES	SE	UK
Y	Y	N	Y	Y	Y	Y	Y	N *	Y	N	Y	N	Y	N *	Y	N	N	N	Y	Y	N	N *	Y	N	Y *	Y	Y

Y (green) = Member States with VAT grouping
N (red) = Member States without VAT grouping
** = Member States allowing a system of consolidation*

Over the years VAT groups have gained importance in the EU. In 2006, there were only thirteen Member States that implemented VAT groups. Now, seventeen Member States have incorporated VAT grouping within their legislation.

Spain permits two types of VAT grouping. The basic type only provides for a consolidated return. Italy, Romania and France do not have VAT grouping provisions but operate consolidation at a VAT return level.

In Belgium, as of 20 August 2015, there were 2962 VAT groups, made up of a total of 9421 taxable persons, having on average 3 members in a group[45]. In Czech Republic, there are 216 VAT groups (approximately 30 in financial sector), having in average 4 members (approximate total of 864 companies). And a last example of Sweden, where as of May 2014 there were 153 VAT groups registered, 67 of which were non-financial businesses (including 36 groups of fully taxed businesses)[46].

There are no statistics on the number of VAT groups in the seventeen Member States of the EU with VAT groups. There is no doubt that they are vast in numbers, considering the amount in Belgium, Czech Republic and Sweden. The existence of VAT grouping is economically very important. A non-published study about cross-border business in the EU and VAT for 27 Member States showed that 15.6% from all cross-border trade within the EU comprised of transactions between multinational groups[47]. The intra-EU numbers represented 7.6% of the GNP of the EU-27. 11.2% of the national trade in the Member

[45] Belgian Cabinet response to the request of our subgroup
[46] Lagradsremiss of 28 May 2014 "Vissa skattefragor infor budgetpropositionen for 201", p. 23.
[47] PwC Study on VAT and Pan-European businesses, not published, p. 136-139.

States would comprise of trade between linked companies with a worth of 22.2% of the GNP. These numbers are estimates made according to a specific method. In practice, the numbers have to be higher, as a transaction in this Study was only considered 'intra-group' from a 50% control. From these numbers, it is clear that VAT grouping is economically very important.

4. The importance of VAT grouping for businesses across industry sectors

A Study for the European Commission of 2006 showed the importance of VAT grouping for the financial and insurance sectors.[48] According to this study more groups appeared to be located in countries with a well working VAT group structure in order to limit the cost of non-deductible VAT on intra-group transactions.

The VAT group is one method to limit the impact of the 'cascade-effect' of non-deductible VAT on wages and profits and to improve competitiveness with institutions outside the EU. The impact of non-deductible VAT is lower outside the EU because of the different indirect tax regimes for the financial and insurance sectors.

The study also suggested making VAT grouping mandatory in all Member States and implementing cross-border VAT grouping to reduce the impact of non-deductible VAT. VAT grouping was also compared to the alternative of cost-sharing associations and its limitations.[49]

Finally it should be noted that VAT grouping is implemented x-industries and by groups of all sizes. The average VAT Group in Belgium has 3 members in 2015and has been adopted mostly by fully taxable business for simplification and cash flow purposes and in a minority of cases by exempt sectors. In Czech Republic, the average number of members is 4 and only ca 14% of groups involve financial sector.

ANNEX II – OVERVIEW OF THE CJEU CASE LAW RELEVANT TO VAT GROUPING

The CJEU has ruled in several judgments on the boundaries that Member States can or have to set to VAT grouping:

1. FCE Bank[50]:

In FCE Bank, the CJEU ruled that services between a fixed establishment and its head office fall outside the scope of VAT.

FCE Bank plc is a UK bank with a branch in Italy. The UK head office supplied a range of consultancy, management, training, data processing and software management services to

[48] "Study to increase the understanding of the economic effects of the VAT exemption for financial and insurance services", 2 November 2006, 22, http://ec.europa.eu/taxation_customs/resources/documents/common/publications/studies/financial_services_study_managementsummary_en.pdf, consulted on 31 July 2015.

[49] "Study to increase the understanding of the economic effects of the VAT exemption for financial and insurance services", 2 November 2006, 36 and 45, http://ec.europa.eu/taxation_customs/resources/documents/common/publications/studies/financial_services_study_managementsummary_en.pdf, consulted on 31 July 2015.

[50] ECJ 23 March 2006, C-210/04, FCE Bank plc, www.curia.eu,Transactions between head office and branch (and vice versa) usually outside of VAT scope.

the Italian branch. The branch, i.e. the fixed establishment of the UK head office, was not constituted as a legal entity distinct from the head office, but was established in another Member State (Italy).

The Italian branch accounted for VAT in accordance with Italian VAT law, but sought repayment of the VAT on the basis that the Italian practice was incorrect.

As services are taxable only if there exists between the service provider and the recipient of the service a legal relationship in which there is a reciprocal performance, the ECJ first examined whether or not FCE IT carried out an independent economic activity.

The CJEU concluded that the branch did not carry out an independent economic activity because of the following facts:

– The branch does not itself bear the economic risks associated with carrying on its business as a credit institution.

– The bank, as a legal person, bears the economic risk and is therefore subject to the supervision of its financial strength and solvency in the Member State of its origin.

– The branch does not have any endowment capital, so the risk associated with economic activity lies wholly with FCE Bank.

Consequently, the branch and the head office form the same legal entity and constitute one taxable person for VAT purposes and thus, the services received from the head office by the branch are not considered as taxable services which fall within the scope of VAT.

2. Infraction procedures from the European Commission[51]

Article 11 of the VAT directive mentions the term ‘persons’. The European Commission argued that ‘persons’ has to be interpreted as ‘taxable persons’ and so non-taxable persons have to be excluded from the VAT group system. The CJEU ruled against this and stated that Article 11 does not imply this. The Court also ruled that Member States can limit the scope of application to specific industries to protect against fraud if the general principles of EU law and the objectives of the VAT Directive are respected.

3. Larentia and Minerva/Marenave[52]:

These cases deal with the question if and when Member States can exclude certain entities from joining a VAT group. The Court ruled that national legislation which restricts the right to form a VAT group, solely to entities with legal personality and linked to the controlling company of that group in a relationship of subordination is precluded, except where those two requirements constitute measures which are appropriate and necessary in order to achieve the objectives to prevent abusive practices or behaviour or to combat tax evasion or tax avoidance, which it is for the referring court to determine. The Court also ruled that (now) Article 11 of the VAT Directive does not have direct effect and it is for

[51] Press release European Commission, VAT: The Commission tackles 8 Member States over the application of the VAT grouping rules, IP/09/1768, 20 November 2009. C-65/11, C-74/11, C-85/11, C-86/11, C-95/11, C-109/11, http://europa.eu/rapid/press-release_IP-09-1768_en.htm ?locale=en.

[52] ECJ 16 July 2015, C-108/14 and 109/14, Larentia and Mineva/Marenave, www.curia.eu.

Member States to define the actual scope of the links required between the members of a VAT group.

4. Ampliscientifica[53]:

When a Member State applies VAT grouping provisions, the companies in the VAT group cease to be considered separate taxable persons. Instead, they are considered one single taxable person with one single VAT number. The judgment also sets out the obligation of Member States to consult the advisory VAT committee if national provisions regarding VAT groups have not yet been introduced.

5. Skandia[54]:

Supplies of services from a main establishment in a third country to its branch in a Member State constitute taxable transactions when the branch belongs to a VAT group. When this main establishment supplies services for consideration to a branch in a Member State belonging to a VAT group, that group, as the purchaser of those services, becomes liable for VAT.

ANNEX III – SKANDIA

1. Detailed analysis of the judgement

Introduction

The CJEU judgment in *Skandia* has given rise to considerable discussion as regards how to interpret the judgment itself and its implications. In this section, the impact of the judgment is discussed.

Skandia is originally a reference for a preliminary ruling from a Swedish (lower) court, following Article 267 TFEU. The Article states that the CJEU of the European Union shall have jurisdiction to give preliminary rulings concerning the interpretation of the Treaties and the validity and interpretation of acts of the institutions, bodies, offices or agencies of the Union. A court or tribunal of Member States may, and if it is a Supreme Court, must, request a preliminary ruling of the CJEU "if it considers that a decision on the question is necessary to enable it to give judgment".

This is the context in which the judgment should be considered. The CJEU, in the context of preliminary references, interprets EU law in so far as is necessary to answer the question put by the national court. There are numerous cases which show the importance of this fact[55].

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[53] ECJ 22 May 2008, C-162/07, Ampliscientifica Srl, www.curia.eu.

[54] See also: I. Lejeune, "Transacties tussen hoofdhuis en vaste inrichting belast als inrichting of hoofdhuis tot fiscale eenheid behoort van 29 september 2014", *TaxTODAY;* ECJ 17 September 2014, C-7/13, Skandia America Corp. (USA), filial Sverige, www.curia.eu, Internal invoicing for the service performed by the head office located in a third country for a branch which is member of a VAT group in a Member State.

[55] See for example Case C-4/94 *BLP* in relation to Case C-29/08 *AB SKF* and Case C-572/07 *Tellmer* in relation to C-392/11 *Field Fisher Waterhouse*. The, at first sight, difference can be explained by the

Nonetheless, the Court usually follows and develops the principles established by previous judgements[56]. In only one VAT case has the Court obviously and explicitly changed a previous position[57].

The opinion of the AG was not followed nor referred to by the Court in its judgement.

Facts and ruling

Skandia America Corporation (SAC) was a company incorporated under the laws of Delaware in the US. It was part of the Old Mutual insurance group, the parent company of which was established in the UK. During 2007 and 2008, SAC acted as the group's global purchasing centre for IT services. SAC distributed the IT services it had acquired from third parties to various companies or branches within the group including to the branch in Sweden.

Since 2007, the Swedish branch (Skandia Sverige) had been a member of the VAT group with Försäkringsaktiebolaget Skandia. It processed the IT services supplied by SAC into the end IT product. This end product was subsequently supplied to group companies within the VAT group as well as to entities outside the VAT group. In all cases there was a mark-up of 5% on the services rendered. Through this set up the group companies within the VAT group could purchase the IT production without VAT, particularly those IT service elements which SAC acquired from third parties. If these had been bought in directly by the relevant group companies in the VAT group they would have been subject to VAT, being in scope of VAT and taxable in the country where the services were received (i.e. Sweden). It is important to note that in Swedish VAT Law there are neither anti-avoidance rules in place in relation to VAT grouping nor general anti-avoidance rules.

The Swedish tax authority (Skatteverket) was of the opinion that SAC's supplies to its Swedish fixed establishment were taxable in Sweden. The fixed establishment of SAC on the other hand is of the opinion that transactions between the business establishment and the fixed establishment are not taxable and that the supplies by the fixed establishment to other members of the VAT group cannot be taxable.

The Förvaltningsrätten (First Tier Administrative Court) in Stockholm decided to refer two questions on the interpretation of the VAT Directive to the CJEU for a preliminary ruling.

The first question asked by the national court was whether externally purchased services from a company's main establishment in a third country to its branch in a Member State, with an allocation of costs for the purchase to the branch, constitute taxable transactions if the branch belongs to a VAT group in the Member State. The second question was whether, if the first was answered in the affirmative, the head office was deemed to be established in Sweden or not, for the purposes of accounting for the supply (in accordance with the rules applicable before 2010).

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different circumstances of the cases (latter example) and the actual question put by the referring, national court (first example).

[56] See, for example the line of cases starting with 268/83 *Rompelman*, followed by C-110/94 *INZO*, C-37/95 *Ghent Coal*, C-110/98 and 147/98 *Gabalfrisa* etc.

[57] Case C-216/97 *Gregg and Gregg* and Case C453/93 Bulthuis Griffioen.

The question as such contains limitations on what the CJEU must answer, in the light of Article 267 TFEU. Above all, it concerns:

1. externally purchased services

2. "paid" for through an allocation of costs for the purchase, and

3. a head office in a third country and a branch in Sweden, which is a member of a Swedish VAT group.

The first question asked is if these externally purchased services, with a cost allocation to the branch, constitute "taxable transactions" for VAT purposes.

The national court did thus not ask whether the cost allocation constituted "taxable transactions for consideration" within the meaning of Article 2.1 of the VAT Directive, but solely whether these were "taxable transactions", i.e. whether the activity came within the scope of Title IV of the VAT Directive[58].

It also deserves to be noted that if the structure in Skandia had not resulted in tax savings, the Court may have ruled differently. The result of treating it as 'not a supply' would have been less non-deductible VAT incurred on acquisitions of taxable IT services. As Skandia is an insurance company, VAT charged would not be fully deductible. Skandia argued, without being disputed on the point, that the non-taxation was a result of the fact that no anti-avoidance legislation was present in Sweden and/or the fact that Article 27 of the VAT Directive, on internal supplies, had not been implemented. As a consequence, the Swedish Government could have enacted legislation to tax the services, but if it had not done so, the transactions could not be taxed. The Court did not, obviously, agree with Skandia, but we believe that the non-existence of anti-avoidance legislation is important to bear in mind when the case is analysed.

The CJEU in its judgment reiterated its previous case law, recognizing the conclusions drawn in *FCE Bank*. It stated that a branch, such as the Swedish branch of a US head office in the case at hand, does not operate independently and does not itself bear the economic risks arising from the exercise of its activity. In addition, as a branch it does not have any capital of its own and its assets belong to the head office, SAC. Consequently, the branch was dependent on SAC and could therefore not itself be characterised as a taxable person[59].

The Court also noted, with reference to *FCE Bank*, that an agreement on the sharing of costs, which took the form in the case in the main proceedings of the issue of internal invoices, is also irrelevant when such an agreement has not been negotiated between independent parties[60].

The Court thereafter stated that it is common ground that the branch in Sweden is a member of a VAT group and that the branch consequently forms with the other members

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[58] Different from in *FCE Bank*, where the national court asked, as an additional question which the Court of Justice did not have to answer, whether the allocation of costs constituted "consideration".

[59] Skandia, par. 26.

[60] Skandia, par. 27.

of the group a single taxable person with a common VAT registration number[61]. With reference to *Ampliscientifica*, the Court noted that the members stop submitting separate VAT returns. It thereafter stated that: “It follows that, in such a situation, the supplies of services made by a third party to a member of a VAT group must be considered, for VAT purposes, to have been made not to that member but to the actual VAT group to which that member belongs”[62].

The conclusion is that services supplied to the branch must be considered to have been supplied to the VAT group[63]. The Court continued: “Inasmuch as the services provided for consideration by a company such as SAC to its branch must be deemed, solely from the point of view of VAT, to have been provided to the VAT group, and inasmuch as that company and that branch cannot be considered to be a single taxable person, it must be concluded that the supply of such services constitutes a taxable transaction, under Article 2(1)(c) of the VAT Directive”[64].

As regards the second question, the Court noted first that the question, “in essence” sought to clarify whether the reverse charge was applicable “in a situation such as that in the main proceedings where the main establishment of a company in a third country supplies services for consideration to a branch of that company in a Member State and where that branch belongs to a VAT group”[65].

The Court’s answer was that the VAT group acquires the services and should account for VAT based on the reverse charge.

Analysis

It is clear from how the judgment is worded that it is based on the facts of the case. The first question answered is whether there are taxable transactions present. Whether the cost sharing agreement in question reflects “consideration” within the meaning of Article 2(1) of the VAT Directive is not discussed. In the second question by the national court, as rephrased by the CJEU, it was even presumed that supplies for consideration were present. Neither is the issue whether there are taxable transactions present in other situations than that present in the case discussed. Strictly speaking the Court did not rule on other situations, for example

- when a branch makes “supplies” to a head office that is a member of VAT group;
- when services are internally produced and allocated and not externally purchased;

[61] Skandia, par. 28.
[62] Skandia, par. 29.
[63] Skandia, par. 30.
[64] Skandia, par. 31. We note that the wording of this paragraph has changed. In the original English version available at the Court’s homepage, it stated that “and as that company and that branch cannot be considered to be a single taxable person”… In the present version, “inasmuch” has been added. Actually, this better reflect the wording of the Swedish original (NB: as this is a Swedish case the only authentic language version is the Swedish one), which reads “under förutsättningen att…”, i.e. “provided that…”. The Swedish version is however not consistent with the French version which does not really give any clear guidance on how this dependent clause should be interpreted (NB: the judgments are drafted in French): “et que celles-ci ne peuvent pas être considérées”.
[65] Skandia, p. 33.

- when only Member States are involved (and no establishment outside the EU);
- when goods are concerned; and
- whether a cost allocation constitutes consideration for services.

Moreover, the CJEU did not rule on a situation where the VAT grouping regime in question is of a different kind than that in Sweden (and all questions associated with that which are analysed in detail in this paper.

Actually, the Court explicitly (at least in the Swedish language version) limited its judgment to the specific kind of VAT groups present in Sweden. These have, in the terminology used in this paper, a narrow understanding of the territorial scope of VAT groups and the term “established” in Article 11 of the VAT Directive. By stating that it is clear that in this case the branch was a member of the VAT group, the Court leaves open what the effect would be if a Member State applies a broad interpretation of the territorial scope in Article 11.

We base this conclusion both from the wording of the judgment, which is further discussed below, from the UK representatives’ submissions at the oral hearing, and a question put by the Court at the oral hearing. The UK representative defended the UK stand point (the broad territorial scope), stating that there were no problems in the UK because of its anti-avoidance legislation. The Court was explicitly asked not to rule on any other VAT grouping regimes than the Swedish one. The parties were also asked, at the oral hearing, whether a judgment stating that the whole legal person was a member of the VAT group would be useful in the national proceedings. The answer from Skandia, which was endorsed as being “presumed to be” correct by the Swedish Government, was that such an answer would not be useful as it followed from the Swedish law that only the branch was a member of the Swedish VAT group.

Furthermore, the Court did not explicitly infer any importance to the fact that a third country was involved. With regard to this fact we refer to the academic discussion of the territorial scope of Article 11[66]. As is clear from the literature, the Commission’s standpoint (the narrow territorial scope) in the Communication of 2009 is not undisputed. Rather, the tendency is to consider that a broad territorial scope must be adhered to or the treatment is not in conformity with primary EU law (the TFEU). Considering this fact, the situation of a non-EU/EU branch/VAT group cannot without reservations be transferred to a purely EU-internal situation.

The Commission considers that it applies to EU internal situations and that the ruling affects also Member States having a different VAT grouping regime than the Swedish one. However, according to the Commission “the validity of the interpretation” of the broad interpretation of the territorial scope of Article 11 of the VAT Directive is not undermined by Skandia. As we can see from the scenarios in Annex V, a combination of a broad and narrow approach often results in conflicts. We hesitate to accept that the Court

[66] See, van Doesum, Van Kesteren and van Norden, ”The Internal Market and VAT: intra-group transactions of branches, subsidiaries and VAT groups” (2007) *EC Tax Review* 1, 35-43, van Doesum and van Norden, ”T(w)o become one: the communication for the Commission on VAT grouping”, *British Tax Review*, (2009), Number 6 p. 657-667, Pfeiffer, *VAT grouping from a European perspective*, IBFD (2015) (forthcoming) and Vyncke, *Btw-eenheid*, Kluwer (2009).

thought about these aspects (and did not only rule on the facts of the case), see also further below.

The Court did not infer any explicit importance to the fact that it was a head office outside the group and not a branch that was involved nor to the direction of the flow of services (from or to the VAT group or to and from a branch or head office or another branch). However, we cannot see that these facts are of any importance for the ruling.

Similarly, the fact that the services were internally produced was not explicitly dealt with as a fact of importance by the Court. Actually, in the Court's rephrasing of the question from the national court, this fact is disregarded. The question was merely whether transactions between the head office and the branch constituted taxable transactions. Our first impression is therefore to conclude that the fact that the services were internally produced was not of decisive importance for the Court.

However, this impression does not stand the test when a purely EU-internal situation is considered. In this situation, the additional fact that domestic transactions between various establishments are not taxed, must be taken into consideration[67]. In order to preserve equal treatment between domestic and intra-EU transactions, only the externally acquired services should arguably be taxed. This reading is also confirmed by the fact that the proposed Article 7(2)(b) of the Sixth VAT Directive was not adopted. Hence, our conclusion, to recommend that the Commission urge the Member States to enact anti-avoidance provisions that tax externally acquired services, in line with the UK anti-avoidance provisions.

The CJEU *did* rule on one, profound issue, namely whether there are supplies of services present in a situation such as that in the case in question. The answer was that the branch, by becoming a member of the VAT group, becomes part of the single taxable person/VAT group and thus dissociates itself from its head office and therefore there are supplies made by the head office to the VAT group for VAT purposes.

A key question when looking at the implications of the judgment is how far-reaching this fundamental stance by the Court is.

Here, the Commission in its paper[68] takes a very broad view. In their paper, they take the view that the judgment applies equally to goods transactions. Similarly to the territorial issue and the EU-internal issue, if this is accepted it gives rise to fundamental issues concerning the current VAT Directive and its application. We fail to see that the Court in any detail considered the application of the judgment outside the facts of the case, which concerned services. The result of an application to transactions in goods would be essentially to do away with a complete set of rules concerning internal transfers of goods cross-border within the EU.

To the best of our understanding, Member States' tax authorities have taken different approaches towards the judgment. Some consider that the judgment applies in line with the Commission's analysis, some consider it only concerns countries with VAT grouping regimes similar to the Swedish one and is irrelevant for all other Member States.

[67] At least if the, what seems to be, prevailing consideration of academics is taken into consideration.
[68] European Commission, Working paper n°845, taxud.c.1(2015)747072, p. 19 and 25.

In an official note, the UK tax authorities, HMRC, have stated that they will apply Skandia if a transaction concerns the UK and a VAT group in a country which applies VAT grouping rules following the narrow territorial approach (Swedish approach)[69]. These transactions thus constitute taxable transactions and should be subject to the VAT rules, provided they are performed for consideration. However, if a transaction concerns a branch or a head office that is not a member of a VAT group, or located in a Member State where there is no VAT grouping regime or which applies a broad territorial approach, there are no taxable transactions present and the principles established in FCE Bank apply.

In our view, it is difficult to reduce the scope of application of the statement that a branch dissociates itself from its head office just because some circumstances are different. It is general in kind.

However, there are also clear limitations to the circumstances of the case, as outlined above.

In our view, the interpretation of the judgment should be looked at in the context of the EU VAT System and the principles upon which it is based. The profound statement that there are taxable transactions between a head office and a branch in this particular situation must be looked at in the light of the particular case and what the effect is if that statement is broadly applied. If new difficulties and inconsistencies arise, it is legitimate to presume that the Court has not contemplated or intended these. It would then be inconsistent with the actual ruling to confer an importance to the case that can never have been intended (as stated, the Court is obliged to provide a clarification of EU law necessary for the national court to rule in the proceedings in front of it – it is not obliged, or even authorized, to create law).

The context of the Court's ruling in Skandia is essentially that the Court states that non-taxation of normally taxable IT services should not occur in the situation at hand. We concur with this conclusion, but consider that any such solution should be made within the realms of the VAT Directive. Not all consumption or value added is taxed under the VAT Directive. Only consumption manifested in supplies made on the market are taxed[70]. One notable exception to this is the deemed taxable transactions which are internal supplies, Articles 18 and 27. These "transactions" are taxed in order to create neutrality between internal supplies and externally acquired services and goods by (partly) exempt traders. The particular purpose of these provisions is to restore neutrality between the decision to contract out or produce internally.

All internal affairs that attract VAT are explicitly regulated in the VAT Directive. To tax branch-head office transactions constitute an exception to the fundamental characteristics of the VAT system that can be justified based on neutrality reasons and is dependent upon the fact that exceptions are present in the system but it needs to be done without creating additional compliance obligations for business, particularly not for business who are fully entitled to deduct input VAT.

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69 Revenue and Customs Brief 2 (2015): VAT grouping rules and the Skandia judgment, https://www.gov.uk/government/publications/revenue-and-customs-brief-2-2015-vat-grouping-rules-and-the-skandia-judgment/revenue-and-customs-brief-2-2015-vat-grouping-rules-and-the-skandia-judgment, consulted on 31 July 2015.

70 As is clear from, for example, Case C-384/95 *Landboden Agrardienste* and Case C-215/94 Mohr.

The fewer exemptions, the less need for special arrangements deviating from the fundamental characteristic of the VAT that it taxes all transactions performed on the market. Hence, the academics suggestions that full taxation should be applied.

If that is not possible, deviations from the fundamental characteristics of the VAT system should only be accepted if those increase neutrality or contribute to achieving a level playing field/neutrality in cross border trade.

2. Impact of Skandia on the application of the principles laid down in the VAT Directive

Further to Skandia, one should analyse to what extent the implementation of the CJEU ruling impacts and/or may overrule the basic principles laid down in the VAT Directive.

A. Impact on basic principles of the VAT Directive

- Principle of territoriality

To the extent the application of the Skandia ruling could become mandatory, the above principles of territoriality and sovereignty will be overruled/limited. Indeed, under this interpretation Member States are obliged to respect VAT rules regarding VAT grouping in other Member States, even if they have not introduced VAT grouping schemes themselves.

- For consideration

According to Article 2 of the VAT Directive, a transaction is subject to VAT if it concerns a supply of goods or services *for consideration* within the territory of a Member State by a taxable person acting as such. Thus, to the extent one should consider transactions between head office and branch as taxable, the consideration for such transaction has to be determined.

In this respect, the transfer pricing rules used for corporate income tax purposes are not useful for VAT purposes as these rules are used for profit allocation whereas the basic principle of consideration within the meaning of Article 2 of the VAT Directive is that there is a direct and immediate link with a transaction.

Here we see a number of complicating issues arising. If Skandia is applied extremely broadly, as suggested by the Commission, this would still not result in legal certainty and foreseeability for traders. Depending on their internal set up and domestic interpretations of the requirement of a direct link between a supply and the consideration paid for it, internal transactions may be taxed or not. We see this issue as potentially a major obstacle to the simple and straight forward application of the VAT system and achieving taxation at the place of destination.

- Risk of double taxation and unintended non-taxation

The application of the Skandia principle could lead to situations of double taxation. As mentioned above regarding the territoriality principle, Member States have to respect the point of view of the Member State in which a certain transaction takes place. If the latter considered the transaction as taxable, then there could be a double taxation where the other Member State (e.g. of the supplier for a service within the meaning of Article 44 of the VAT Directive) refused the right of input VAT deduction for the supplier because, the transaction is not taxable in that Member State. The reverse is also true so that the supplier's Member State may treat the transaction as taxable (outside the scope with recovery) but the Member State of the receiver may treat the transaction as VAT exempt.

Indeed, the right of deduction of VAT is a national prerogative of a Member State and thus, each Member State should determine whether a transaction is taxable or not when deciding on the right of input VAT deduction.

- Breach of fiscal neutrality principle

Fiscal neutrality within the VAT systems implies, amongst others, that the same transaction should be treated equally regardless of whether a branch, member of a VAT group, who receives services from its head office, is established within a Member State with the same (broad or narrow) approach as its head office or with a different approach.

If Skandia principles will be applicable, this will not be the case as transactions between a branch, a member of a VAT group and its head office abroad will be taxable whereas the transactions will be out of scope of VAT if transactions are supplied by the head office to a branch established in another Member State where it is not part of a VAT group.

- Internally generated supplies

Based on the Skandia principles, internally generated services could become taxable, which would increase the VAT costs for some groups of companies.

The integrity of the VAT system dictates that cross border supplies of services (in a B2B context) are, in principle, taxed in the jurisdiction of consumption, consistent with the destination principle of taxation. It seems to us that the reason why the case was taken to court was to ensure (and preserve) this principle. In a general sense, and consistent with the judgment in the Skandia case, we believe that it would not be too controversial to say that businesses would by and large expect, and accept, that for third party services (in cases similar to Skandia) the associated costs should always be subject to VAT in the jurisdiction where those services are received and the costs are borne (i.e. in the Skandia case, in Sweden).

It is, however, also important to recognise that the case was about third party costs and not internally generated costs (i.e. it dealt with the treatment of costs bought in by SAC from third party suppliers that were recharged/allocated to SAC Sweden for recharge to other fellow VAT group members in Sweden). The question arises as to whether internal costs would, or should, follow the same treatment.

The distinction between internal and external costs is a very important one and touches on a core technical issue; specifically the territorial application of Article 11, i.e. the status of intra group supplies, specifically supplies made by group members from establishments outside the relevant jurisdiction when an EU Member State implements a VAT grouping arrangement in accordance with Art 11. And should the cost composition of those supplies – as between internal and external costs – characterise the VAT treatment?

The paper published by the European Commission (dated February 17, 2015) anticipates this discussion and sets out the "dichotomy" between the broad and narrow territorial interpretations of Art 11.

Recognising that there is such a dichotomy of interpretations – and perhaps a dichotomy that cannot be resolved – then (without prejudice to the question of consideration which is considered earlier) if the objective is to maintain a system of taxation for third party costs in the jurisdiction in which those costs are borne, the key issue is what form of anti-abuse measures should be adopted by Member States under Art 11. Such measures are required to ensure external costs are taxed appropriately and for there to a uniformity of application in terms of these anti-abuse measures.

But equally as important is the principle that in the case of intra company (or intra VAT group) transactions (under both broad and narrow territorial interpretations) internal labour costs should not be taxed.

B. Scope of application of Skandia

- Head office – branch transactions

The CJEU has clearly ruled in Skandia on a certain specific transaction. However, based on the general wording of the CJEU, one could argue that the principles derived from the Skandia case can be applied on all possible transactions.

In this regard, the European Commission has stated in its Working Paper No 845 that the scope of the Skandia case is not restricted to “head office to branch” supplies, but also vice versa, i.e. “branch to head office” supplies.

Furthermore the European Commission specified that it is not relevant whether the head office is established outside the EU or in another Member State and in what direction the services are provided, nor whether the services are bought-in externally or are internally-generated.

- Supply of goods and other services

The principle of Skandia could also have an impact on the supply of goods and other services, such as services within the meaning of Article 47 of the VAT Directive.

C. Impact on compliance

If the Skandia principles are generally applied, this would lead in practice to practical inconveniences. When a supplier provides services (within the meaning of Article 44 of the VAT Directive) to its customer established in another Member State, the supplier has to know whether the customer is member of a VAT group and if so, whether the invoice should show the VAT number of the VAT group or the VAT number of the member, i.e. its customer.

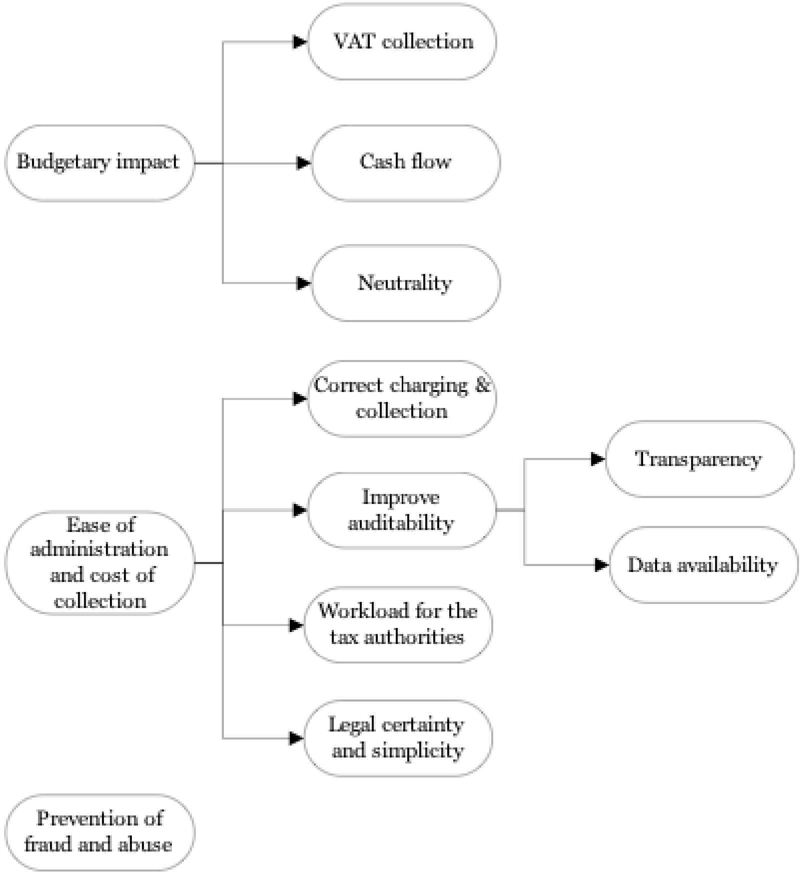
Furthermore, the supplier would also have to be aware whether the receiving Member State followed a broad or narrow interpretation, especially in the case of head office-branch transactions, and whether that Member State has implemented anti-abuse provisions.

This is where (as covered Annex I section 2. second feature), the fiction of VAT grouping now suddenly interacts in commercial activities between trading parties, which it should not do. Legal and commercial practices should prevail since, based on the neutrality of VAT, VAT should not impact on commercial transactions, VAT should only draw conclusions out of these commercial transactions for VAT purposes and should not drive commercial practices and create new compliance obligations.

DRAFT[71] – ANNEX IV – ANALYSIS OF IMPACT ON SPECIFIC TRANSACTIONS

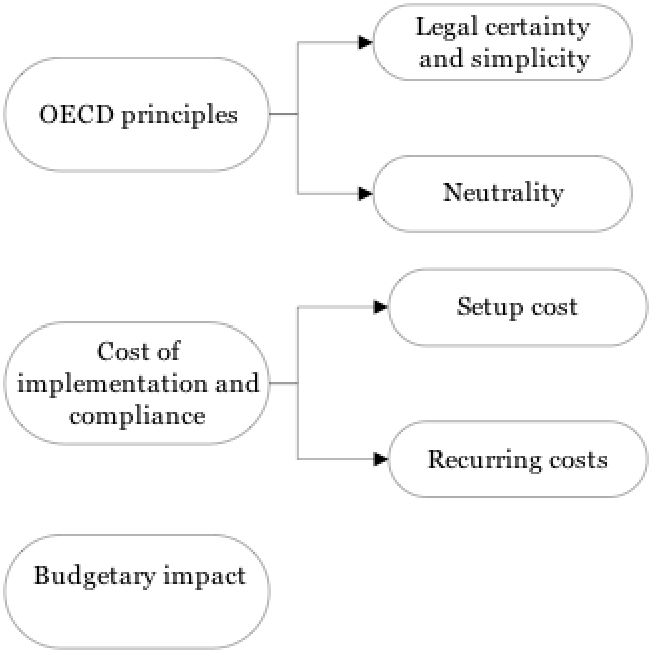
1. Impact assessment criteria

Figure 1 – Criteria from a tax authority's perspective



[71] This Annex is a working draft which can be developed further should the VEG find it useful

Figure 2 – Criteria from a taxable person's perspective



From a Tax Authority's perspective				***From a Taxable Person's perspective (customer and supplier)***			
Budgetary impact		***Ease of administra-tion and cost of collection***	***Prevention of fraud and abuse***	***OECD principles***		***Cost of implementa-tion and compliance***	***Budgetary impact***
Cash flow	***Revenue***			***Legal certainty and simplicity***	***Neutrality***		
- = negative impact on cash flow	*- = loss of VAT income*	*- = additional effort costs likely*	*- = not resistant to existing types of fraud*	*- = less certainty and simplicity*	*- = less neutrality*	*- = negative impact on cash flow*	*- = increase costs*

2. Application of current EU VAT principles

2.1. Article 2 – impact

<u>Head office– branch transactions</u>

- **One taxable person (Article 2 of the VAT Directive)**

If we should consider the branch and its head office as one taxable person within the meaning of Article 2 of the VAT Directive, charges between these two entities of one legal person fall outside the scope of VAT, according to the CJEU in the FCE Bank case. In FCE Bank, the CJEU stated that a fixed establishment which is not a legal entity distinct from the company of which it forms part, established in another Member State and to which the company supplies services, should not be treated as a taxable person by reason of costs imputed to it in respect of those supplies and therefore, supplies of services within the same legal entity does not fall within the scope of VAT.

- **Two taxable persons**

If however the Skandia principles are applied in such a case, this would mean that there is a taxable transaction as the supply between the branch, being member of a VAT group, and its foreign head office is a transaction between two separate taxable persons, despite the FCE Bank case and despite the difficulties encountered related to Article 2 of the VAT Directive.

As a consequence, those Member States which do have not implemented Article 11 of the VAT Directive will have to disregard their own national legislation in order to respect the Skandia principles.

In this event a supplementary complication is that, one should determine the consideration within the meaning of Article 2 of the VAT Directive of this taxable transaction. As stated by the CJEU in the Tolsma case[72], remuneration for reciprocal performance is mandatory in order to have a taxable supply.

In this respect, the CJEU stated in paragraph 31 of the Skandia case that a service is only taxable in case a remuneration is provided.

> *"<u>Inasmuch</u> as the services provided for consideration by a company such as SAC to its branch must be deemed, solely from the point of view of VAT, to have been provided to the VAT group, and inasmuch as that company and that branch cannot be considered to be a single taxable person, it must be concluded that the supply of such services constitutes a taxable transaction, under Article 2(1)(c) of the VAT Directive."*

However, according to the Swedish version of the Skandia case (which was the court case language of the Skandia case), it was not stated "inasmuch" but "I den mån" which means "insofar" or "provided that". Consequently, it appears that a supply of services between a branch, being a member of a VAT group, and its foreign head office is only taxable under the condition that remuneration for the supply was provided.

[72] ECJ, C-16/93, (Tolsma), 3 March 1994, www.curia.eu.

Consequently, in case one would consider that a taxable transaction is present in the event of a transaction between a branch, being a member of a VAT group and its foreign head office, then it should be established how to determine the remuneration. As mentioned above, transfer pricing rules are not that useful for VAT purposes.

If one concludes there is no remuneration, then it follows from the Skandia case, paragraph 31, that the transaction between a branch, being a member of a VAT group and its foreign head office falls outside the scope of VAT. Member States can however avoid this result by implementing an anti-abuse measure. In this respect, the VAT Directive provides several possibilities. An example would be the Belgian anti-abuse measure, which taxes the services (being services within the meaning of article 44 of the VAT Directive) from a taxable person established outside Belgium to one of its establishments which is member of a Belgian VAT group. Since July 1, 2015, the provision has been abolished as a result of the Skandia case[73].

The UK has also implemented an anti-abuse measure. Under the UK anti-abuse rules, a supply within a VAT group is deprived of its VAT-free (out of scope) status when supplied by a non-UK-based VAT group member to a UK VAT group member where (i) the overseas member has procured taxable services from third party suppliers ("bought-in services") which it then uses to make the onward intra-VAT group supply, and (ii) that intra-VAT group supply would otherwise be a taxable supply in the UK.

Member States which have not implemented Article 11 of the VAT Directive can also implement anti-abuse measures based on Article 273 of the VAT Directive.

A third option in order to tax such transaction is to tax it as a self-supply according to Article 27 of the VAT Directive since it is a transaction within one legal entity. However, introduction of such rules should not impose new compliance obligations for businesses who can fully deduct input VAT or hinder commerce and should ensure the neutrality of taxation (particularly for the exempt sector). International best practices may be worth considering for an effective mitigation of any “artificial” VAT cost (VAT on internal labour elements).

Impact

As proven by the assessment (all scenarios are impacted), such a mismatch between a broad and a narrow approach has the following impacts:

Tax authority’s perspective

- distortion of territoriality and subsidiarity principles, as a Member State (of a head office) has to adjust its national legislation to apply Skandia principles

- high cost of administration due to the increased complexity of rules on VAT grouping and an obligation to take into account the implementation of Article 11 in other Member States

- potential increase in tax avoidance and evasion due to mismatches between national regimes and complexity of tax audits

[73] Abolishment of 19bis of the Belgian VAT code as of 1 July 2015

Business perspective

- distortion of neutrality principle, as business needs to apply a different treatment to its intra-company transactions, depending on whether the branch in another Member State belongs to a VAT group and whether that other Member State applies a broad or a narrow approach to VAT grouping.

- high compliance costs due to multiple and diverging treatment of internal supplies

- potential budgetary impact as businesses may not be able to deduct input VAT on the "supplier" side despite applying VAT on internal supplies from the "recipient" side

2.2. Taxable persons (Articles 9–13)

Principles

As a general rule, a "taxable person" is any person that independently carries out in any place any economic activity, whatever the purpose or results of that activity.

Impact

Head office to branch transactions: one or two taxable persons

The two approaches also create a mismatch regarding the definition of taxable person. A broad approach treats the head office and branch as a one taxable person (FCE Bank), whilst the narrow approach separates them into two taxable persons (Skandia).

Tax authority perspective

- Same as in 4.2.1.

- Different aspects of this impact have been brought out in following points (registration, liability etc.)

Taxable person perspective

- Same as in 4.2.1

- Different aspects of this impact have been brought out in following points (registration, liability etc.)

2.3. Taxable transactions (Articles 14–30)

Impact

Transactions (deemed or otherwise) carried out between members should be seen to be outside the scope of VAT. Hence, the focus should be put on transactions between the group and third parties as those transactions should not be disregarded for VAT purposes. When the group acquires goods or services from third parties or non-group members, for example non-EU subsidiaries, such acquisitions would either qualify as supplies of goods or supplies of services.

In the case of supplies of goods, such supplies can either constitute intra-Community acquisitions (deemed or otherwise), imports or alternatively "normal" supplies of goods, i.e. local/domestic supplies. Where the group supplies goods or services to third parties for consideration, such supplies would either constitute supplies of goods, intra-Community supplies (deemed or otherwise) or supplies of services.

In addition, in certain circumstances, a group member or members may make self-supplies. This type of supply may arise for example where a member with full input VAT deductibility acquires goods (inventory, capital equipment, etc.) on behalf of the group and there is a subsequent change in use by one of the members where a full input VAT deductibility would not have arisen where VAT is charged on the transfer or acquisition of those goods.

In conclusion, Skandia dealt with externally bought services. The extension of its application to goods or internally generated supplies would have significant impact on businesses and tax authorities. The relevant impacts to both sides are:

<u>Tax authority perspective</u>

- Budgetary impact due to potential impact on place of supply (see 4.2.4.)
- Increased enforcement and administrative costs from complex compliance control (e.g. regarding taxation of internal supplies)

<u>Taxable person perspective</u>

- Regarding internal supplies:
- Budgetary impact from taxation of labour costs
- Increased compliance costs and difficulties regarding identifying the consideration
- Regarding goods and other services:
- Potential impact on liability and compliance requirements if place of supply is impacted as a consequence of extension to goods or other services (see 4.2.4.)
- Impact on importation process: confusion over who is the importer

2.4. Place of taxable transactions (Articles 31–61)

2.4.1. Place of Supply of Goods (deemed or otherwise)

The application of the Skandia principles on other transactions such as supply of goods or real estate services can also give rise to some practical issues. The European Commission dealt with the question of whether the Skandia case is also relevant for the supply of goods in its report of 17 February 2015 further to the Skandia case.

According to the European Commission, cross border transactions are in general taxable. A supply of goods will be taxable as a transfer within the meaning of Article 17 of the

VAT Directive if it concerns business assets whereas an importation into the EU is always a taxable event for VAT purposes.

The statement of the European Commission is of course correct, but still, the application of the Skandia case could lead to practical issues, for instance in case of importation of goods (e.g. who will be the addressee?), sale of stocks present in a different Member State than the one of establishment of the VAT Group (e.g. would the Member States in which the stock is located consider the sale as a taxable transaction which takes place within its territory or accept out of scope since it concerns a transaction between Members of a VAT group?), triangular operations (e.g. can the simplified regime for triangulation be applied), etc.

There are also difficulties in applying the conclusions of Skandia in the case of services performed between two members of a VAT Group whereby the place of taxation is different than the one determined on the basis of Article 44 VAT Directive, such as Article 47 of the VAT Directive for, amongst others, real estate services.

2.4.2. Place of Supply of Services

Principles

In general, while there are exceptions, supplies of services between two taxable persons (B2B) are deemed to take place where the customer has established his business or, if more appropriate, has a fixed establishment to which the service is supplied. In the case where the customer is a non-taxable person (B2C), the place of supply is where the supplier has established his business or, if more appropriate, has a fixed establishment from which the service is supplied.

2.4.3. Place of Importation

Principles

As a general rule, the importation of goods is currently treated as taking place in the Member State where the goods are when they enter the Community.

Impact on place of supply of goods or services

Extending Skandia to other services and goods may cause place of supply issues and related issues with taxing rights and business liability (see Scenarios 3 and 5).

<u>Tax authority perspective</u>

- Budgetary impact: taxation rights of a Member State where supply takes place due to a special place of supply rule (e.g. Art 47) may be impacted.
- Impact on taxation rights when goods are located in a Member State other than the head office or branch/VAT group: is it taxable transaction or out of scope?
- Impact on application of triangulation rules

Taxable person perspective

- Confusion on who is required to register in a Member State where supply takes place (Art 47 or Art 31, 32) – head office or VAT group (including branch)

- Risk of multiple VAT registrations of the same entity

2.5. Taxable amount (Articles 72–92)

(a) Principles

In principle the taxable amount includes everything that constitutes the consideration that is received by the supplier (or the supplier is entitled to receive), in return for the supply, from the customer or from a third party (including subsidies directly linked with the price).

For deemed intra-Community supplies and likewise for deemed intra-Community acquisitions, the taxable amount consists of the purchase price of the goods or similar goods. In the absence of a purchase price, the taxable amount consists of the cost price determined at time of transaction.

In general, the taxable amount on importation is the value for customs purposes, determined in accordance with the Community provisions and includes the incidental expenses up to the place of first destination within the territory of the EU where this place is known at the time of importation.

(b) Impact

Even in the specific facts in Skandia the intra-company transactions could be taxed only where there was a consideration. However, determining the existence of direct consideration and correct taxable amount will be challenging for businesses.

Tax authority perspective

- Budgetary impact: lack of clarity on taxable amount will impact the collectible VAT

- Increase in administrative burden due to complexity in auditing of taxable amount and pricing of intra-company transactions

Taxable person perspective

- Increase in compliance cost due to complexity of determining the taxable amount on inter-company supplies, as the existing cost allocation and transfer pricing arrangements may often not be appropriate

- Potential budgetary impact where business is obliged (by national rules) to determine the taxable amount of internal supplies where by commercial reality there would be no consideration, especially e.g. taxation of labour costs

2.6. VAT rates (Articles 93–130)

Principles

In the different Member States standard VAT rates of at least 15 percent (of the taxable amount) are applicable and apply to the supply, intra-Community acquisition and importation of goods and to the supply of services.

Derogations aside (which allow Member States to apply zero-rating in certain instances), in addition to the standard VAT rate, in some Member States one or two reduced VAT rates of at least 5 percent apply (on the taxable amount). Those reduced rates can only be applied to those categories of goods and services specified in Annex III to the VAT Directive, i.e. goods and services that are seen as basic necessities or are of a social or cultural nature.

Impact

The implementation of Skandia makes intra-company transactions taxable, which therefore makes them also subject to the VAT rate in the Member State of the branch or head office/VAT group.

2.7. Exemptions (Articles 131–166)

Principles

Intra-Community supplies and exportations are exempt from VAT while the right of VAT deduction incurred on related costs remains in place.

A range of financial services are VAT exempt without a right of VAT deduction. A similar status also applies to a range of activities carried out in the public interest.

Impact

The implementation of Skandia makes intra-company transactions taxable, which therefore makes them also subject to the exemption regime in the Member State of the branch or head office/VAT group. This may impact the right to input VAT deduction of the head office or the branch (see point 4.2.8.)

2.8. Liability (Articles 192a–205)

Principles

As a general rule the taxable person carrying out the taxable supply of goods or services is liable to account for the tax due on the transaction to the relevant tax authorities.

In most of the cases where B2B services are supplied cross-border, the recipient of the services is required to self-assess the VAT amount due and account for VAT as payable in his local VAT return under the “reverse-charge mechanism”.

Some Member States require that in the event the taxable person that makes the supply is not established within the Member State of supply, then the person liable to account for the tax is the person to whom the taxable supply of goods or services is made to, i.e. a "domestic" reverse-charge mechanism for non-established suppliers.

In addition, a Member State may require that someone other than the taxable person liable for the payment of the VAT can be held jointly and severally liable for the payment of the VAT in all the situations mentioned in Articles 193 to 200 and 202 to 204 of the VAT Directive. In general, this principle does not apply to import VAT.

Impact

Several potential impacts of Skandia on the liability for businesses to register for VAT and account for VAT have been identified above, e.g. in relation to any place of supply impact or extension to goods (including the impact on import liabilities) and other services.

2.9. VAT Deduction (Articles 167–192)

Principles

In so far as the goods and services are used for the purposes of taxable transactions, the taxable person is entitled to deduct the VAT due or paid in respect of related supplies of goods or services.

Generally speaking, the rules of deductibility are governed by the VAT Directive. However it should be noted that limitations in terms of deductibility do exist between Member States. Such limitations, at a Member State level, will continue to exist.

Impact

Taxation of intra-company transactions may have an impact on the right of deduction of the head office. The mismatch between the broad and the narrow approaches in Member States where the head office and branch/VAT group are located, may create (in)direct double taxation (see scenario 1.3) or non-taxation (see scenario 1.2).

The combination with the implementation of the Credit Lyonnais judgment may also cause indirect double taxation, as the transaction is taxed on the recipient's side but the related input tax has to be disregarded for the head office's partial exemption purposes.

2.10. Compliance requirements

2.10.1. Registration/ identification for VAT purposes (Articles 213–216)

Every taxable person must inform his national tax administration when his activity as a taxable person commences, changes or ceases. In addition, Member States shall also take necessary measures to ensure certain other persons are identified by means of an individual number.

2.10.2. Invoicing (Articles 217– 240)

2.10.3. Books and records (including archiving) (Articles 242–249)

2.10.4. VAT related reporting obligations

2.10.4.1. VAT return (Articles 250–261)

Existing VAT provisions state that every taxable person has an obligation to submit, for each taxable period, a VAT return containing all the information as required in order to calculate the ultimate tax liability.

2.10.4.2. EU Sales Listings for goods and services (Articles 262–271)

Taxable persons identified for VAT purposes are required to submit recapitulative statements in accordance with the procedures to be determined by the Member States (i.e. combined or separately) regarding their:

Exempt (deemed) intra-Community supplies of goods;

Supplies of services covered by the general B2B place of supply rules where the recipient of the service has to account for the VAT due under the "reverse-charge mechanism", unless these services are exempt in the country of the recipient.

2.10.4.3. Optional statement of intra-Community acquisitions (EU Acquisitions Listings) (Article 268)

In addition to the EU Sales Listing, some Member States may require the submission of quarterly or monthly statements of intra-Community acquisitions.

2.10.4.4. Domestic listings (Article 261)

Member States may impose other obligations which they deem necessary to ensure the correct collection of VAT and to prevent tax evasion. These obligations are subject to the requirement of equal treatment as between domestic transactions and transactions carried out between Member States by taxable persons and such obligations may not, in terms of trade between Member States, give rise to additional formalities connected with the crossing of internal frontiers.

In some Member States, for example Spain, Belgium, Italy etc., taxable persons are required to submit domestic listings. For example a listing identifying all taxable persons for which he has made local supplies.

2.10.4.5. VAT collection

Taxation principles should ensure that the right amount of tax is paid at the right time in the right jurisdiction. The collection model should support the fair treatment of taxable persons and the reduction of tax evasion and fraud.

2.10.4.6. VAT audits

Every taxable person is required to keep accounts in sufficient detail for VAT to be applied and for application of the tax to be checked by the tax authorities. Taxable persons are also required to make invoices or information that is stored in accordance with the VAT Directive available to the authorities without undue delay if and when requested.

Checks by the relevant tax authorities are usually carried out by way of periodic audits at the premises of the taxable person.

It should be borne in mind that the rules regarding these audits are not currently harmonised at an EU level. Each individual Member State has its own specific rules and regulations in this respect.

Impact

2.10.4.7. Enforcement and collection

The rules and regulations with regard to VAT inspections/audits, the prescription periods and penalties are not currently harmonised at an EU level. These matters are currently within the exclusive jurisdiction of the Member States.

Impact on compliance requirements

A wide implementation of Skandia may have an impact on business' compliance requirements, such as on registration (see 4.2.4.) and on invoicing and reporting of taxable inter-company transactions.

2.11. Allocation of costs

The Court has not analysed the impact of allocating costs in Skandia. It would be farfetched to draw such conclusions from the judgment. The allocation of costs can only be in scope of VAT if further to Article 2(1)(c) of the VAT Directive:

- it concerns a supply between 2 taxable persons and
- it is made for consideration.

Where a head office and its branch are not 2 taxable persons but only 1 further to FCE Bank (except in case of allocation of endowment capital to the branch) there is no need to review the second condition.

When it would concern 2 taxable persons there must be consideration before any allocation of costs can be in scope of VAT.

In its working document the Commission refers to the EDM case[74].

Further to the settled case law of the court, a supply is effected 'for consideration' within the meaning of Article 2 of the VAT Directive, and hence is taxable, only if there is a legal relationship between the provider of the supply and the recipient pursuant to which

[74] ECJ 29 April 2004, C-77/01

there is reciprocal performance. In that case the remuneration received by the provider of the service constituting the value actually given in return for the supply made to the recipient.

The supply will therefore only be taxed where there is an agreement between the parties and in so far as there is a link between the supply made and the payments to which it gives rise.[75]

A head office and its branch cannot conclude an agreement being the same legal entity and reciprocal performance is absent.

The fact that one of those entities belongs to a VAT group does not change the need to meet those conditions.

Impact

The Court has not analysed the impact of allocating costs in Skandia. It would be farfetched to draw such conclusions from the judgment. The allocation of costs can only be in the scope of VAT if further to Article 2(1)(c) of the VAT Directive:

- it concerns a supply between two taxable persons and
- it is made for consideration.

Even when it would concern two taxable persons (e.g. as in Skandia) there must be consideration before any allocation of costs can be within the scope of VAT.

ANNEX V – DETAILED ASSESSMENT OF TRANSACTION SCENARIOS

1. Introduction

As mentioned in the report, the VEG has asked our task team to assess the impact of Skandia ruling and prepare a report of our findings.

The task team started the assessment by analysing a list of scenarios based on different types of transactions, which may be impacted by the ruling. In the course of the analysis several scenarios were removed, as the impact was minimal, or combined with other scenarios, as the impact was very similar.

This Annex contains the analysis of the remaining seven scenarios, most impacted by the Skandia ruling, which formed the basis for the main report. They have been grouped in 2 basic scenarios regarding services and 5 specific scenarios.

The **two basic scenarios** cover:

- Scenario 1: Head office is not part of a VAT group in supplier's country
- Scenario 2: Head office is part of a VAT group in supplier's country

The **five specific scenarios** cover:

[75] ECJ Case C-16/93, Tolsma, 3 March 1994 par. 14 and 17.

- Scenario 3: Real estate services from one member of a VAT group to another member
- Scenario 4: Transaction from non-EU branch to other branch which is member of a VAT Group in recipient's country
- Scenario 5:Transactions of goods
- Scenario 6: Re-invoicing to third parties
- Scenario 7: Reallocation of costs / Cost sharing

In order to assess the impact of Skandia it is important to recognise that the manner in which Article 11 is implemented (i.e. in those Member States that have opted to implement it) is not consistent across Member States. Some Member States have adopted what we have referred to as a "*broad interpretation*" of Article 11 whereas others have adopted a more restricted or "*narrow*" interpretation. The distinction between these interpretations is explained in more detail in Part 2 of the report, but to illustrate the impact of Skandia in the following scenarios we have generically categorised Member States based on which interpretation they apply.

The Member States (MS) have been grouped into **three different types** as follows:

- MS 1 (supplier's side) & MS 3 (recipient's side): Member States with a **narrow** interpretation of Article 11 (e.g. Belgium, Sweden, Germany) **(BLUE);**
- MS 2 (supplier's side) & MS 4 (recipient's side): Member States with a **broad** interpretation of Article 11 (e.g. UK and the Netherlands) **(RED);**
- MS 5: Member States which have **not** implemented art. 11 of the VAT Directive and do not provide the possibility in their legislation to establish a VAT group, however in cross-border situations they may follow either narrow or broad interpretation (e.g. Luxembourg) **(BLACK).**

Also in conducting the assessment of the various transaction scenarios, we have applied a set of pre-determined **assessment criteria**, applying the EU VAT principles including the following aspects:

- Taxable persons
- Taxable transactions
- Place of taxation
- Taxable amount
- Liability
- VAT deduction (supplier)
- Formalities

- Impact of anti-abuse measures
- Impact (principles / commercial, legal reality)

This Annex is intended as a higher level summary of the more detailed analysis which was carried out by completing a grid, presented in the Annex VI.

2. Summary of the assessment

The analysis of the Transaction scenarios highlights a number of important issues to be considered in terms of the implementation of the Skandia judgement, not least challenges that might arise practically when assessing the VAT treatment for each of the transactions both from a liability and deduction perspective and also the associated compliance and reporting obligations.

But first and foremost the scenarios highlight the question of the sustainability of the broad and narrow territorial interpretations of Article 11 in light of the judgement in the Skandia case. Can both co-exist? Assuming that they can continue to co-exist, the scenarios show potentially anomalous situations that can arise in practice because of these differing approaches. In other words situations where a liability can arise with no corresponding right to deduct input tax on associated costs and in other circumstances no taxation arising at all.

The basic scenarios (**Scenarios 1 and 2**) illustrate that when Member States adopt a narrow territorial interpretation of Article 11 (and the implementation of VAT grouping in their respective Member States) and the transactions qualify to be treated as supplies of services under Article 44, then in theory the implementation of Skandia would be relatively straightforward and uncomplicated, notwithstanding potentially significant issues around how to determine and value the consideration given for the transaction. Clearly in these scenarios there is a consistency of approach across the Member States and the existing VAT framework is capable of dealing with the issues of liability and deduction and the associated compliance and reporting obligations.

However as these scenarios also illustrate, not all Member States adopt such a uniform interpretation of Article 11 and not all transaction categories are in respect of services that fall under Article 44. So in relation to the former the Transaction scenarios illustrate that the anomalies and tensions that can arise for example conferring an entitlement to input VAT deduction for a supplier that is not matched by a corresponding supply or liability for the recipient and in other cases potential non taxation. Clearly such anomalies undermine the basic integrity of the tax.

The transactions covered by Scenario 1 also show the impact where the receiving branch (which is a member of a VAT group in MS 3 or 4 as the case maybe) recharges the costs that have been charged by the HO to other group members and where there is no recharge. The analysis shows that the distinction between recharging and no recharging has no impact on the VAT analysis.

Scenario 3 illustrates the a potential outcome where a service provider provides real estate related services to a fellow VAT group member in one jurisdiction (i.e. MS 3/4) but the related immovable goods are actually located in another (MS 1/2/5) – if all Member States take the view that the VAT group must be recognised does that mean that MS 1/2/5 loses taxing rights in respect of the supply?.

The transactions in the other Scenarios illustrate some of the compliance challenges that could arise in a post Skandia world.

For example in **Scenario 4** (in the context of a transaction involving a non-EU branch of a legal entity that provides services to a branch in another jurisdiction (not the jurisdiction of the HO) shows how potentially multiple registration obligations for the same legal entity could arise in the receiving branch's jurisdiction in the event that it (the non EU branch) either incurs costs (with VAT) in the receiving branch's jurisdiction or engages in some activity that might require it to separately register for VAT in that jurisdiction.

Scenario 5 illustrates the challenges around transactions in goods, including importations where a branch is VAT group registered in a Member State with other related entities and goods are imported by both the branch and those other related entities. The question arises as to who will act as importer or as addressee for the importation – the branch, the group itself, individual members of the group? And which VAT number will be communicated to the Customs authorities? Additionally which valuation will be used use for importation purposes?

Other scenarios involving transactions in goods (for example, Scenario 5.2) illustrates the practical difficulties that might arise where a Head Office (based in MS 1 or MS 2) supplies goods to a VAT group member in MS 3 or MS 4 and a branch of that HO is a member of the VAT group in MS 3 or MS 4 and where there is a subsequent sale (or multiple sales) between group members and followed by a sale to an external third party based in another MS. Can the simplified measures for triangulation (as laid out in Article 141) apply in such circumstances? Scenarios 5.3 and 5.4 also demonstrate that anomalies can arise in the context of transactions in goods where one MS does not recognise a VAT group in another.

Scenario 5 also illustrates other practical challenges when goods are involved, and shows that, depending on the approach to recognition of VAT groups in other Member States, multiple registrations for the same legal entity could arise.

Scenario 6 shows the practical difficulties for tax payers and tax administrations in a re-invoicing scenario again primarily due to the different interpretations of Art 11 and the recognition – or otherwise – of VAT groups in different Member States as constituting separate taxable persons.

Finally **Scenario 7** deals with costs allocations and cost sharing between a branch and Head office where one or either is a member of a VAT group and highlights the possible anomalous positions that can arise if a supply is recognised in such situations by differing interpretations of Art 11 and the recognition, or otherwise, of VAT groups in other Member States as constituting a separate taxable person.

3. Assessment of the various scenarios

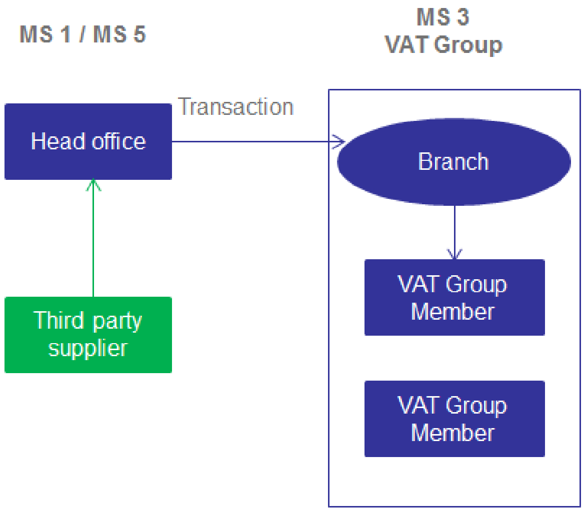
SCENARIO 1

Head office is not part of a VAT group in supplier's country

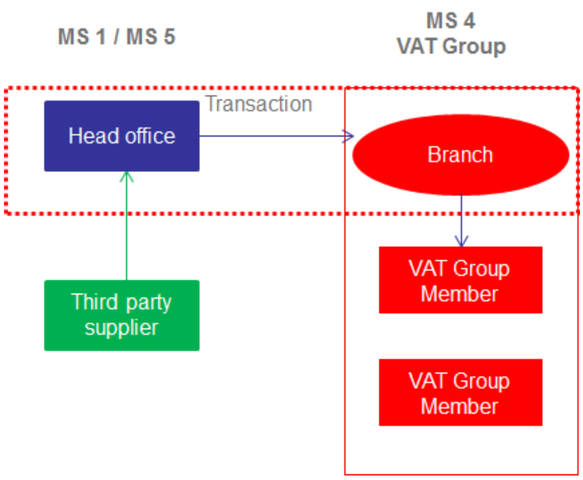
Scenario 1 groups together eight scenarios, illustrating different impacts of a transaction between the head office and a branch (in a VAT group), depending on the narrow or broad interpretation of the VAT grouping.

Scenarios 1.1 and 1.2 illustrate the significance of the broad and narrow interpretations of Article 11 (and how VAT grouping is implemented in Member States). In both scenarios the branch incurring the cost (from its HO) recharges some or all of those costs to fellow VAT group members in MS 3 or MS 4, as the case maybe.

Scenario 1.1



Scenario 1.2



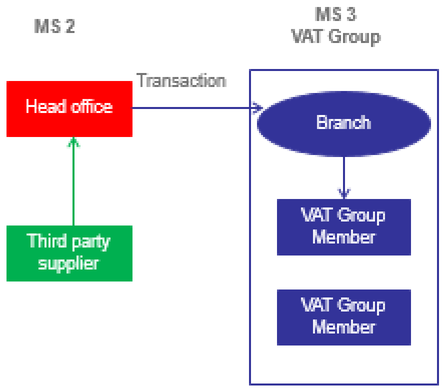
Scenario 1.1 assumes that, consistent with the Commission's view as articulated in the 2009 Communication, on joining the VAT group in MS 3 the HO and branch are separated for VAT purposes and consequentially a supply is made by the HO in MS 1 to the recipient (being the VAT group) in MS 3. Therefore assuming the services are of a type that come within the scope of Article 44 no VAT is charged by the supplier and the VAT group (as recipient) self accounts for the relevant VAT in MS 3 with deductibility (or a measure of deductibility) subject to the status and profile of the recipient VAT group.

Therefore in Scenario 1.1, to the extent that the HO incurs costs (e.g. from a third party supplier) and effectively on-supplies (or recharges) those costs to its branch based in MS 3 (which is a member of a VAT group) – in circumstances where that recharge qualifies as a supply – then supplies made and received (from both an MS 1 and MS 3 perspective) are recognised for liability, deduction and reporting purposes. Skandia will have little, if any, further impact in such a scenario.

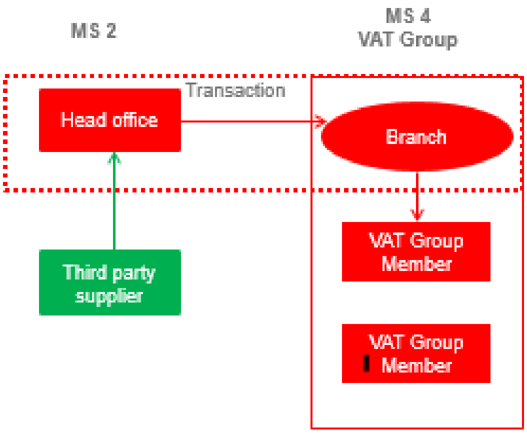
In contrast in Scenario 1.2 the recipient is based in a Member State (MS 4) that adopts a broad interpretation of Article 11 and hence does not recognise a discrete supply as having being received by the VAT group so therefore no VAT liability arises on receipt. However the HO as supplier (based in MS 1) recognises such a supply albeit one that is made to a recipient (being the VAT group) based in MS 4. This clearly leads to an anomalous position whereby the supplier is entitled to recover associated input tax (in MS 1) on the basis that the HO is making a supply whereas there is no such corresponding supply received in MS 4 resulting in an infringement of the principles of fiscal neutrality.

Scenarios 1.3 and 1.4 both involve a supplier based in MS 2 recharging costs to a branch in MS 3 (narrow interpretation of Article 11) and MS 4 (broad interpretation of Article 11) and where in both circumstances the branch on-supplies the relevant services to a fellow VAT group member.

Scenario 1.3



Scenario 1.4



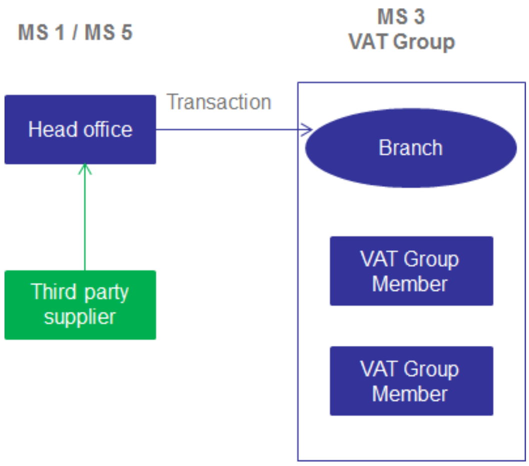
In the context of Scenario 1.3 there is no (independent) taxable supply being made by the Head Office to the branch from an MS 2 perspective. However MS 3 recognises that the recharge from HO to the branch is a service received from a separate taxable person in another EU Member State (MS 2) that gives rise to a liability to VAT (assuming of course that the services concerned are taxable reverse charge services). The VAT group will be required to self assess the VAT in respect of the consideration paid for that service and will be entitled to a deduction (or partial deduction) subject to the VAT group's status and profile.

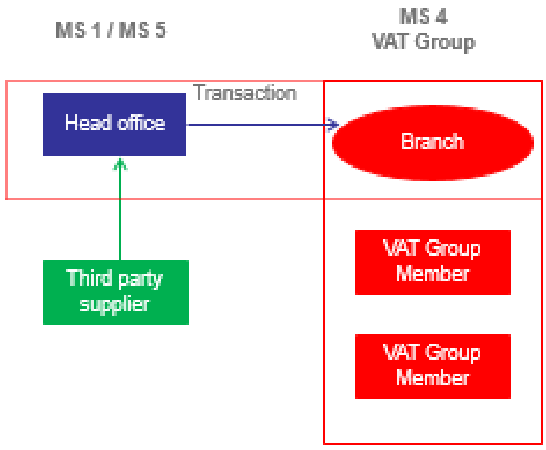
Scenario 1.3 illustrates a potential anomalous position as to the extent that any of the costs concerned have to be bought in from a third party supplier in MS 2, potentially those costs cannot be linked to a taxable supply by the HO and therefore may preclude deductibility in MS 2 of the relevant input VAT (notwithstanding that output tax has been accounted for by the VAT group (of which the branch is a member) in MS 3).

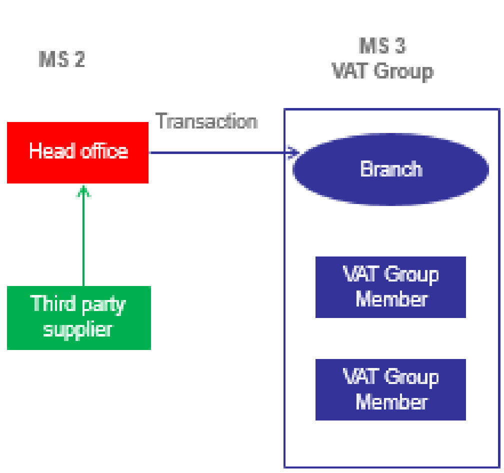
In terms of Scenario 1.4 both MS 2 and MS 4 adopt a broad interpretation and therefore, as we would see it, the transactions between the HO and the branch and the VAT group members are disregarded. Input VAT incurred on any related third party costs will therefore be claimed (or otherwise) dependant on the HO's status and profile in MS 2.

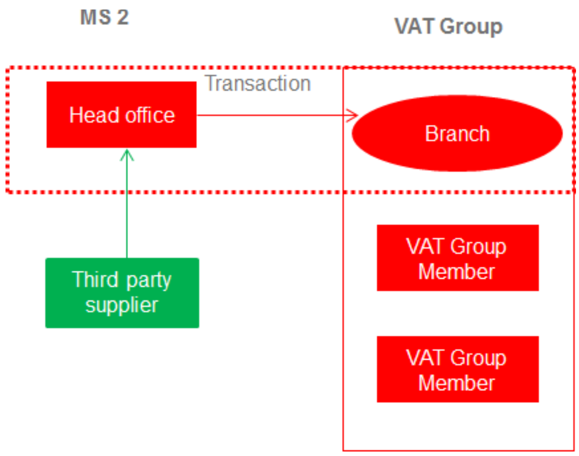
Scenarios 1.5 through to 1.8 illustrate the VAT treatment where the services are received in similar circumstances to the above but there is **no** recharge within the VAT group.

Scenario 1.5 **Scenario 1.6**









In one sense the VAT treatment remains the same as for Scenarios 1.1–1.4 but the important distinction here is that in these Scenarios (1.5–1.8) the branch in MS 3 or MS 4 is receiving the services for its own business purposes (i.e. the branch activities) whereas in Scenarios 1.1 to 1.4 there is a recharge to fellow group members. The distinction is important because it focuses on a critical question – should the principle in the FCE Bank be preserved or retained in the context of services supplied by a Head Office direct to a branch (without recharge) and where there is a recharge in order to preserve the neutrality of the VAT system should anti abuse provision be implemented.

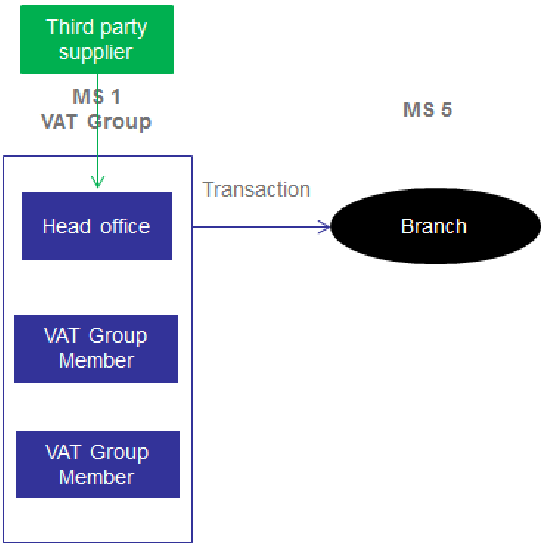
SCENARIO 2

Head office is part of a VAT group in supplier's country

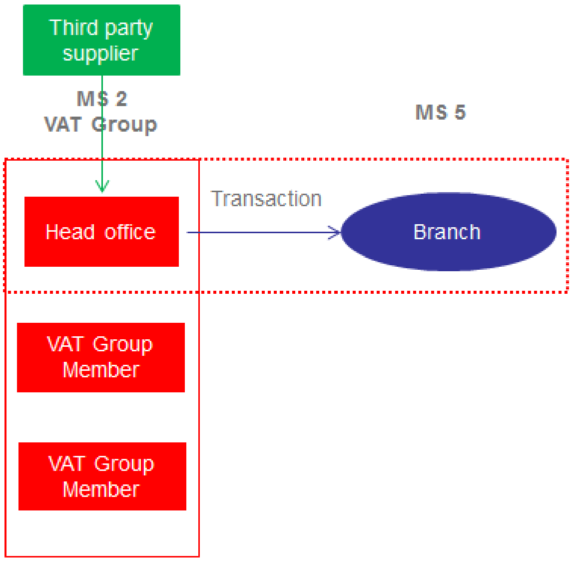
The second group of scenarios (2.1–2.6) considers the potential VAT analysis where the head office is part of a VAT group in the supplier's country and there is no recharge with the VAT group.

Scenario 2.1 and 2.6 involve supplies purchased in one Member State by the head office (a member of a VAT group) which then recharges costs to a branch in another Member State which does not recognise the concept of VAT grouping.

Scenario 2.1



Scenario 2.6

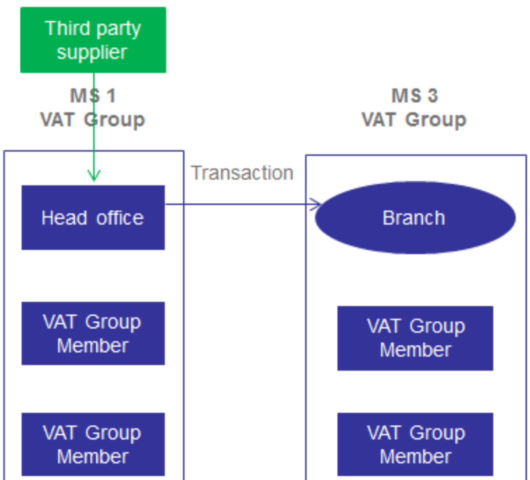


In scenario 2.1, MS 1 adopts a narrow interpretation of Article 11, thus supplies are recognised by the VAT group in MS 1 when a recharge is made to the branch in MS 5. Provided the services fall within the scope of Article 44 no VAT is due on the recharge, but the VAT group would be in a position to recover any VAT charged by the supplier to the extent that the provision of the goods/services would in principle be taxable. The VAT treatment applicable to the branch in MS 5 depends on the approach adopted in circumstances where the national Member State legislation does not provide any possibility to establish a VAT group. An approach based on the FCE case would result in no supply being recognised in MS 5 (even though a supply and corresponding input tax deduction would be realised in MS 1), whilst an approach based on Skandia would result in a requirement to apply the reverse charge in MS 5 with deductibility subject to the status and profile of the branch.

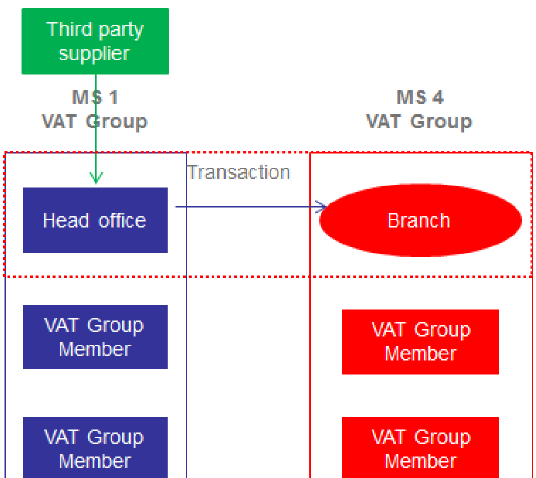
In scenario 2.6, MS 2 would consider the recharge to the branch as a disregarded intra-VAT group supply. Recovery of VAT charged by the supplier would then depend on the status and profile of the VAT group in MS 2. The VAT analysis as regards the receipt of the recharge in MS5 would be as set out above for scenario 2.1

Scenarios 2.2 to 2.5 involve supplies purchased in one Member State by the head office (a member of a VAT group) which then recharges costs to a branch (a member of a VAT group) in another Member State.

Scenario 2.2



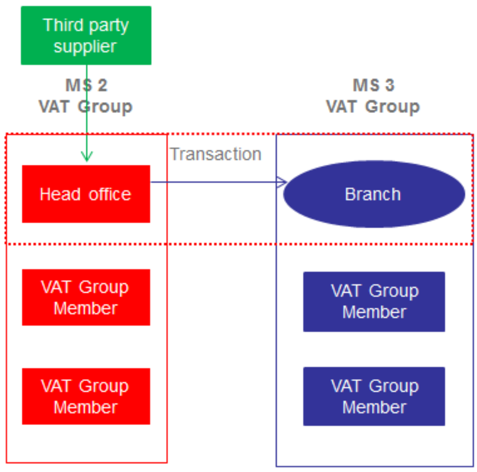
Scenario 2.3



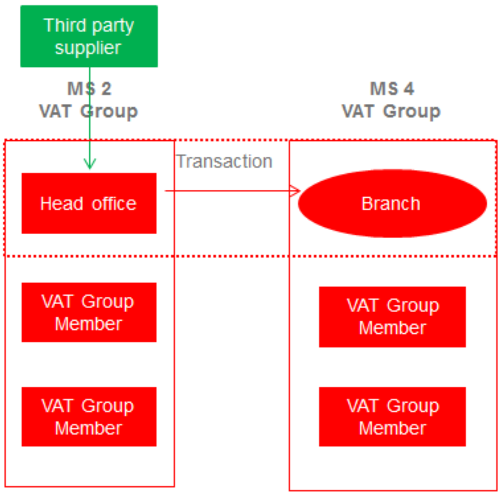
In scenario 2.2, a supply is recognised in both Member States as being made by the VAT group in MS 1 to the VAT group in MS 3. Provided the services fall within the scope of Article 44 no VAT is due on the recharge, but the head office VAT group would be in a position to recover any VAT charged by the supplier to the extent that the provision of the goods/services would in principle be taxable. The corresponding VAT treatment applicable in MS 3 would require the branch to account for the reverse charge and recover the related input tax subject to the status and profile of the VAT group of which the branch is a member.

In scenario 2.3, the VAT analysis for the head office recharge would be the same as set out above for scenario 2.2. However, MS 4 would consider the recharge to the branch as a disregarded intra-VAT group supply, therefore not subject to a reverse charge. Recovery of VAT charged by the supplier to the head office would then depend on the status and profile of the VAT group in MS 1.

Scenario 2.4



Scenario 2.5



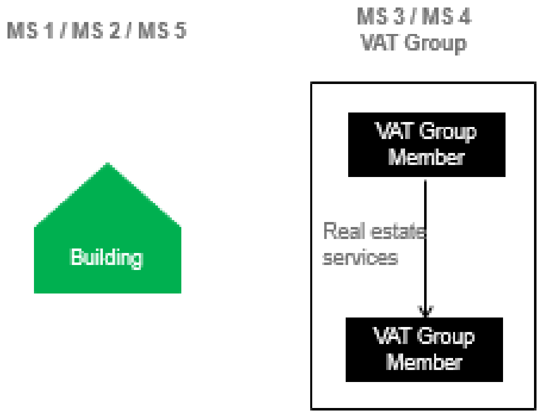
In **scenario 2.4,** MS 2 would consider the recharge to the branch as a disregarded intra-VAT group supply. Recovery of VAT charged by the supplier would then depend on the status and profile of the VAT group in MS 2. However, the VAT treatment applicable in MS3 would require the branch to account for the reverse charge and recover the related input tax subject to the status and profile of the VAT group of which it is a member.

In **scenario 2.5**, the VAT analysis for the head office recharge would be the same as set out above for scenario 2.3. However, MS 4 would consider the recharge to the branch as a disregarded intra-VAT group supply, therefore not subject to a reverse charge. Recovery of VAT charged by the supplier to the head office would then depend on the status and profile of the VAT group in MS 2.

SCENARIO 3

Real estate services from one member of a VAT group to another member

Scenario 3 illustrates difficulties to apply the conclusions of Skandia in case of services performed between two members of a VAT Group whereby the place of taxation is different than the one determined on the basis of Article 44 VAT Directive 2006/112/EC. This could be the case if the place of taxation is located in another Member State than the one of establishment of the VAT Group. The most obvious example is the supply of real estate services.



Scenario 3 assumes that the real estate services are performed between two members of a VAT Group in MS 3 / MS 4. Consequently, the transaction should in principle be out of scope of VAT.

However, the place of taxation should be determined on the basis of Article 47 VAT Directive 2006/112/EC and, as the real estate is located in MS 1, MS 2 or MS 5, the real estate services should thus be deemed to take place in MS 1, MS 2 or MS 5. The latter Member States should determine the VAT treatment of the transaction since the supply of services is deemed to take place in their Member State.

Nonetheless, on the basis of Skandia, all Member States should take the position that the existence of a VAT Group prevails on any other considerations, such as the place of taxation. Consequently, all Member States should consider the real estate services as a transaction outside the scope of VAT.

Despite the position of Skandia, Member States could still take different approaches. For instance, MS 1, MS 2 or MS 5 could disregard the existence of the VAT Group in MS 3 / MS 4 based on the territoriality principle of Article 11 VAT Directive 2006/112/EC.

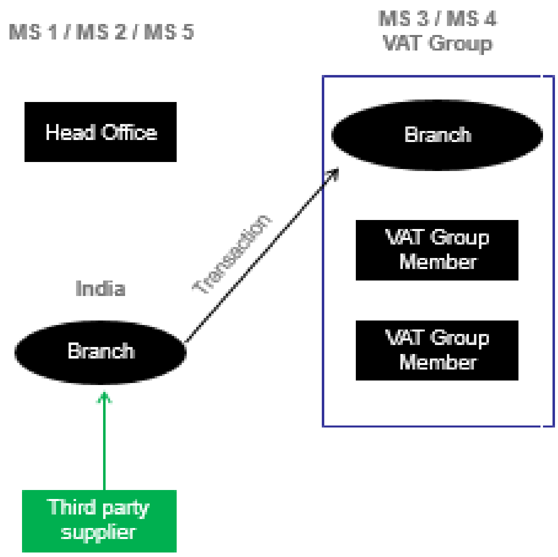
Consequently, the supplier of the real estate services should then account for the VAT due in MS 1 / MS 2 / MS 5. A possible consequence could be that the recipient of the services could have a 'purchase' fixed establishment in the Member State where the real estate is located.

The different approaches of Member States could lead to a supplementary VAT charge, being the taxation in MS 1 / MS 2 / MS 5 and limitation of input VAT in MS 3 / MS 4.

SCENARIO 4

<u>Transaction from non-EU branch to other branch which is member of a VAT Group in recipient's country</u>

This scenario reviews a situation when a branch situated in a third country, with a head office in MS 1, MS 2 or MS 5 provides a supply to a branch in MS 3 or MS 4. The head office, as such, is not particularly involved in the supply.



Supposing the branch in a third country may act independently to the extent that it can provide supplies (i.e. of services, art. 44 of the VAT Directive), if the transaction can be regarded as a taxable supply, we do not see any major difference between such scenario and the Skandia situation. Thus the issues arising under this scenario are comparable to issues of Skandia as such.

As regard the definition of a taxable person, the situation may differ between a supply to MS 3 and MS 4. While in a situation with a supply to MS 3, the branch in a third country will not be included per definition in the VAT group (narrow approach to the territoriality principle) and a transaction would be taxed, a supply to MS 4 with a broad territoriality approach may or may not be taxable, depending on the fact (i) whether MS 4 applies broad territoriality approach also to branches (and head offices) in third countries (this may easily be so since the head office with its branches still forms one legal person regardless where its individual parts are situated) or (ii) whether such transaction is caught by anti-avoidance measures in MS 4. In the case that the branch belongs to a VAT group with limited input deduction, additional costs of non-deductible VAT would arise in MS 3 compared to MS 4, thus causing competition issues.

Also in this scenario further issues may arise in the area of VAT refunds and multiple registration of the same entity in situation when the branch in a third country either receives a supply in the MS 3 not attributable to the branch in MS 3, where it would be entitled for VAT refund, or, respectively, it provides a supply taxable in MS 3, where the branch situated in MS 3 (a part of a VAT group) is not involved, which is taxable by the supplier (ie. reverse charge on the recipient does not apply). One company may thus face really multiple registration, i.e. in situation, where the head office is situated in MS 1 and it is a part of a VAT group there, and thus "constitutes" a separate taxable person (together with other members of the VAT group) from both its branch situated in MS 3 and its branch situated in a third country.

Multiple registration will thus impose further administrative burden both to such company and also for the MS 3 tax administration, many times with difficulties to attribute convincingly a transaction to the "individual" parts of the same legal entity. With the (increasing) numbers of registration in one and the same member state all relevant duties are also multiplying, starting from booking and recording obligations, reporting and filing obligations, VAT payments issues[76], numbers of VAT audits and reports, including enforcement. One can also, in this case, easily see the problems in different treatment of the same situation depending on the fact whether the relevant member state applies broad (how broad? also including third countries?) or narrow interpretation of the territoriality principle.

SCENARIO 5

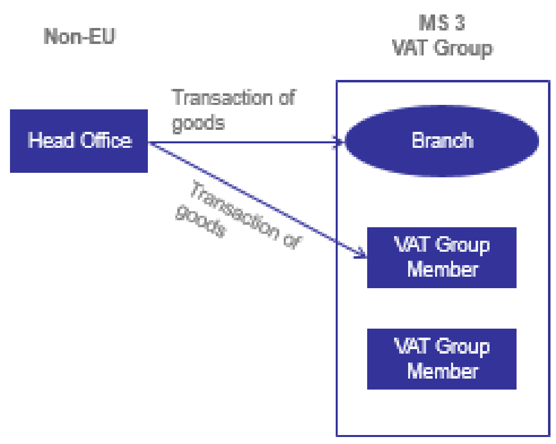
Transactions of goods

Scenario 5 considers the potential VAT analysis where supplies of goods are involved. Although not dealt with as such in Skandia, it is also worth to consider the impact of Skandia on the supplies of goods. At first glance, the impact seems to be negligible. However, practice shows that Skandia can have an important impact on *e.g.* importation of goods, sale of stocks present in a different Member State than the one of establishment of the VAT Group, triangular operations, etc.

Scenario 5.1 illustrates difficulties encountered when importing goods from non-EU Member States.

Scenario 5.1

[76] One can only wonder how a member state would approach a situation where the head office has tax arrears while its branch registered in a VAT group has tax overpayments. Will the overpaid tax be returned to the branch? Or not, and it will be offset against the tax arrears of the head office? On what grounds, when for registration, taxation, reporting, filing and most probably payment requirements they are considered to be (completely) independent?



Practical issues will be *i.e.* (i) who will act as addressee for the importation: the branch, a VAT Group Member or the VAT Group as such; (ii) which VAT number will be communicated; and (iii) how will the latter be in line with customs legislation under which the VAT Group is not identified as a person as such?

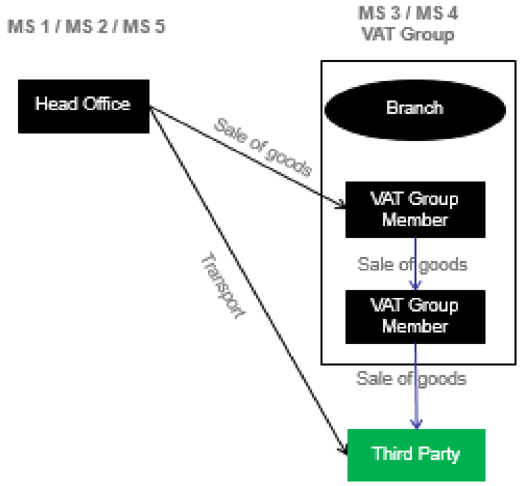
The importation into MS 3 is the taxable event. The main question will be who will act as importer of the goods.

Based on Skandia, we should conclude that the VAT Group should be the one importing the goods, instead of its members. The consequence is that a supply of goods will take place outside the EU followed by an importation of goods in the EU by the VAT Group. If the VAT Group acts as importer, the question will be whether the customs authorities will accept an import document with as addressee the VAT Group, not being the purchaser or the owner of the goods.

Besides the question who will act as importer, other questions also arise: (i) which valuation should be used for the importation; and (ii) will the VAT Group be entitled to recover the input VAT on the importation?

The main issue in **scenario 5.2** is the question whether the sale from one VAT Group Member to the other should be considered as a taxable supply of goods bearing in mind that the place of taxation is MS 1, MS 2 or MS 5, *i.e.* the Member State where the transport starts. Based on the answer hereof, one should furthermore determine where the intra-Community supply of goods takes place.

Scenario 5.2



The latter is relevant for the applicability of the simplified measures for triangulation (Article 141 VAT Directive 2006/112/EC). This regime can only be applied if there are *i.e.* three parties involved and the intra-Community supply takes place in the first supply. In case more parties are involved, the simplified regime can in principle not be applied.

In the case at hand, the simplification can only be applied if the involved parties are the Head Office, the VAT Group and the Third Party. Based on the Skandia interpretations, the conditions for the simplification measures could be fulfilled. Of course, this should be reflected in the European Sales Listing, indicating code "T" and the VAT number of the VAT Group.

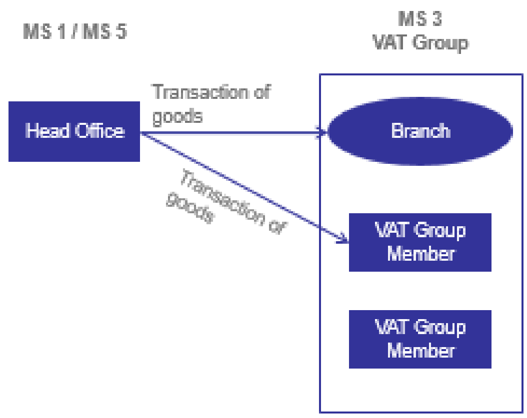
According to MS 3 / MS 4 the on sale within the VAT Group internally will not be a taxable transaction, whereas MS 5 could disregard the existence of the VAT Group.

This could lead to a mismatch. For instance, the Head Office can report the VAT number of the VAT Group Member in its European Sales Listing under code "L". The same goes for the Third Party if he would not recognize the existence of the VAT Group.

If no simplification measures for triangulation can be applied, the VAT Group should register for VAT purposes in the Member State of the Third Party or MS 1 / MS 2 / MS 5.

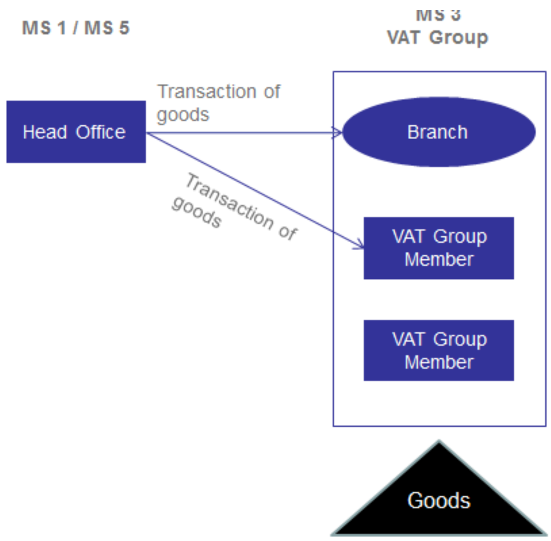
A supplementary complication is that many Member States – despite the fact that they accept the figure of the VAT Group – still require that intra-Community supplies of goods should be reported under the VAT number of the individual member of the VAT Group.

Scenario 5.3a involves the purchase of goods in one Member State by the head office which then supplies the goods to its branch (a member of a VAT group) in another Member State. The head office also makes supplies of goods to other members of the VAT group of which the branch is a part.



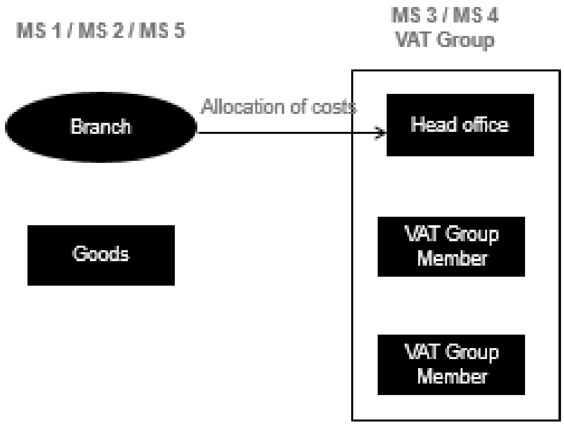
Under Article 17(1) of the VAT Directive, the transfer by a taxable person of goods forming part of his business assets to another Member State is treated as a supply of goods for consideration. Generally, unless simplification reliefs apply, such a deemed supply results in a zero-rated sale from the Member State of dispatch and a registration and taxable acquisition in the Member State of destination. However, in scenario 5.3a where MS 3 applies a narrow interpretation of Article 11, on the basis that the head office and branch are separated for VAT purposes it appears that there should now be a supply between separate taxable persons – i.e. acquisition VAT accounted for by the VAT group and no deemed supply.

Scenario 5.3b involves the same fact pattern as 5.3a, however, in this scenario the goods are already located in MS 3.



On the basis that the head office owns and supplies goods that already reside in MS 3, the question arises as to whether the head office would be required to register and charge local VAT to the VAT group in MS 3. To date the prevailing view is that a single legal entity could only maintain a single VAT registration in each Member State. However, the analysis in the Skandia case that a head office and its branches are separate taxable persons could suggest that in certain scenarios a legal entity may be required to register more than once in a Member State in order to account for VAT on supplies made between the head office and local branch.

In **scenario 5.4**, goods are present in MS 1/MS 2 or MS 5. These goods remain in the same Member State. However, for one reason or the other, the cost of the goods is allocated from the branch to the head office in MS 3 or MS 4, which is a member of a VAT group in that country. The reason for the allocation could be manifold, such as an internal restructuring, where goods at a warehouse is allocated to the head office instead of the branch following a transfer of the management of a warehousing activity to the head office.



The first issue that arises is of course whether the allocation of costs constitutes the consideration for a supply of goods. In order for there to be a supply of goods, the right to dispose of the goods as owner has to be transferred to another taxable person, compare Article 14 of the VAT Directive. In order for it to be a supply for consideration, the allocation of the costs have to be linked to the supply of the goods, Article 2 of the VAT Directive.

In the situation where the branch is in MS 1, this would, presumably, be considered as a supply, although it can be questioned if the allocation of costs within a "legal" entity, further to FCE Bank can be "consideration" and if such a supply can be taxed – further to the non-adopted provision to tax in specific cases internal supplies between the member of a group. If the Head office is a member of a VAT group in MS 3, the VAT group will acquire goods in MS 1 and would receive VAT on the invoice for the goods. Either this VAT would have to be recovered through the refund procedure, or the VAT group would have to register in MS 1 for supplies made from that MS with the goods. MS 1 would likely respect this, as the same regime exists in their MS (narrow approach). If MS 2 and MS 4 are involved, no effects occur and no transactions will be accounted for.

If the perspectives mismatch, in this particular situation, it may be solvable.

First, MS 1 or MS 2 has the taxing rights, following Article 31. The fact that MS 2 may not recognise a supply that MS 3 considers to be present, may not constitute a problem as the goods are in MS 2 and the place of supply is MS 2, following Article 31. The problem arises when the locally charged VAT should be refunded or deducted. If MS 3 is involved, the VAT group would ask for a refund, if goods are in MS 1, yet if goods are in MS 2, no supply will be made and no VAT charged. Similarly, if goods are in MS 5, as MS 5 has the taxing rights, no VAT would be due (provided they do not recognise VAT groups) and the legal entity as such will still be considered as the owner of the goods.

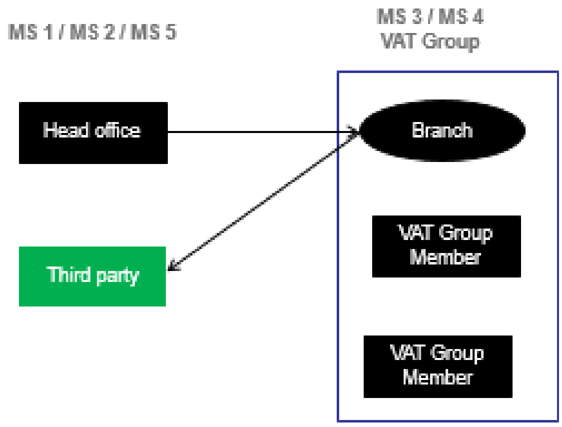
The problem also arises if VAT charged is not fully deductible. Then there will be a VAT cost in MS 1 countries but not in MS 2 countries.

In practice, with different VAT registrations for the branch and the VAT group, the goods will all of a sudden be sold by another entity than the one that bought or constructed the goods. The traceability is thus lacking, which is a practical problem. Yet, if it arises that is nothing new compared to the present situation – even if no VAT groups are present the same "problem" appears.

SCENARIO 6

Re-invoicing to third parties

This scenario brings further complexities to various issues, it describes a situation where (for whatever reason) a supply is firstly charged by a head office in one MS (transaction 1; hereinafter T1) to a branch being a member of a VAT group in another MS, while this supply is not (ultimately) attributable to the branch and is (partially or fully) re-invoiced to a third party in the same MS where the head office is situated (transaction 2; hereinafter T2).



If this scenario occurs in a "mixed" situation (the head office and a third party situated in MS 1/2/5 and the branch being a member to a VAT group in MS 3/4, or vice versa), all the issues and mismatches as described in various situations described above will apply here as well. The following options may arise:

- T1 goes from MS 1 (taxable) to MS 4 (out of scope, FCE Bank applies), and T2 thus goes from MS 4 (taxable) to a third person (taxable); MS 1 does not recognize T2, since for them the head office is "separated" from its branch .

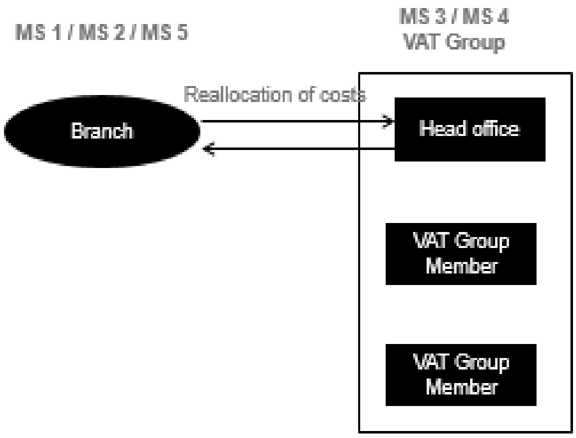
- T1 goes from MS 2 (out of scope, FCE Bank applies) to MS 3 (taxable), and T2 goes from MS 3 (taxable) to a third person (taxable); MS2 requires the head office to tax T2 since it is a transaction provided by a taxable person with its seat in MS 2 (the head office and the branch are not "separated" from the MS 2 perspective, since MS 2 applies the broad interpretation of the territoriality principle). Two member states may require to tax the same transaction, so this scenario may easily end up in double taxation.

- Again, this scenario shows that mismatches caused by different interpretation of the same VAT concepts create environment which will be causing many practical difficulties both to the tax payers and to the tax administrations.

SCENARIO 7

Reallocation of costs / Cost sharing

In the last scenario, some branch costs are allocated to the head office. This may occur for various reasons, for example for transfer pricing purposes to reflect the fact that the head office should carry some costs associated with the business as a whole. This cost allocation in no way has to represent supplies made to the head office or the VAT group in MS 3/MS 4 specifically, even though there may be situation in which it is directly linked to services supplied. It may also concern general functions of the group of companies and all branches, the cost of which the company has deemed should be carried by the head office. Examples are costs for the legal entity as such, legal entity marketing costs etc.



The first question that arises is whether this is at all a supply for consideration, which may not always be the case.

Provided that a supply for consideration is present, a number of mismatches arises. If the branch is in MS 1, and the VAT group in MS 4, there may be a situation of non-taxation. From the branches perspective, there is a supply, and if it is taxed, the right to deduct exists. However, in MS 4 it is not considered that anything has been acquired from MS 1, so no reverse charge of itself reverse chargeable services (presuming Article 44 applies) occurs.

If MS 5 is the Member State where the branch is located, it may not recognise foreign VAT groups and therefore not allow a deduction of VAT, despite the fact that in a Skandia-analysis, MS 3 considers that the acquisition is taxable. For partly exempt businesses that acquire external supplies in MS5 and onward supply them to the VAT group, double taxation may occur due to non-deductible input VAT in the hands of the branch and non-deductible input VAT on the reverse charge by the VAT group in MS 3.

ANNEX VI GRID: TRANSACTION SCENARIOS

The last Annex contains a more detailed analysis of the transaction scenarios, which was carried out by completing a grid (provided in a separate document (in excel format)[77])

The purpose of the grid is to illustrate possible issues, inconsistencies and anomalies in the various scenarios, highlight potentially problematic issues and ultimately assist (and support) conclusions and recommendations that are drawn from the analysis.

The grid is setting out the responses for each scenario by reference to the relevant assessment criteria. Responses in the grid are shown as Y (for yes, confirmed), N (for no, not confirmed), NA (for not applicable) and P (for problematic – in other words some aspect of the analysis presents some class of issue or problem).

[77] The grid can be found as an appendix to this annex (see separate document).