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VALUE ADDED TAX COMMITTEE
(ARTICLE 398 OF DIRECTIVE 2006/112/EC)
WORKING PAPER NO 845

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 group

1. INTRODUCTION

The Commission services wish to discuss with the VAT Committee certain 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 Directive², including whether the conclusions drawn by the CJEU are applicable in circumstances which differ from the facts of the case. The dispute 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.

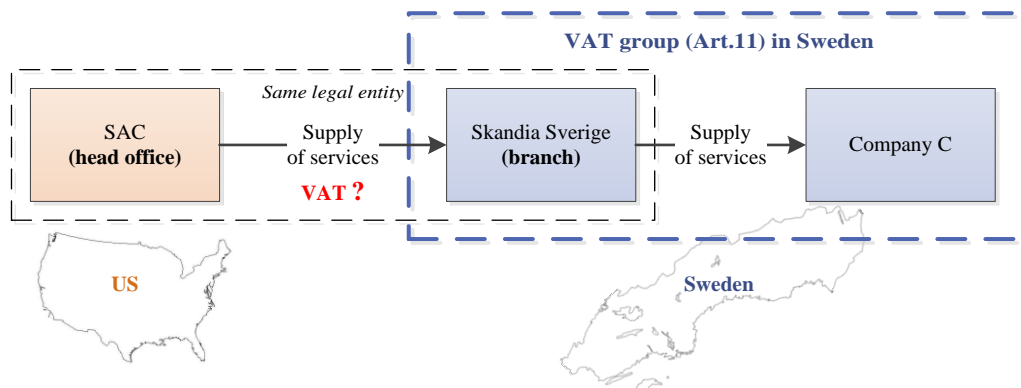
For the sake of legal certainty, it is highly desirable to reach a common and consistent position on the consequences derived from the judgment of the CJEU in this case.

Future developments concerning VAT groups and its membership are expected from the CJEU in the pending case C-108/14 *Larentia + Minerva*³.

2. THE CIRCUMSTANCES OF CASE C-7/13

In 2007 and 2008, Skandia America Corporation (SAC) acted as the global purchasing company for IT services on behalf of the Skandia group and carried out its activities in Sweden through its branch, Skandia Sverige. SAC distributed externally purchased IT services to various entities in the Skandia group, including Skandia Sverige which, since 11 July 2007, had been registered as a member of a VAT group in Sweden.

Skandia Sverige was tasked with processing the externally purchased IT services to produce the final product which was then supplied to various entities in the Skandia group, both within and outside the VAT group. A mark-up of 5% was charged on each supply of services. Costs were allocated between SAC and Skandia Sverige by the issue of internal invoices.



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

³ Request for a preliminary ruling from the Bundesfinanzhof (Germany) lodged on 6 March 2014.

3. THE QUESTIONS REFERRED TO THE CJEU

The Swedish tax authorities were of the opinion that SAC's supplies of services to the Swedish branch constituted transactions taxable in Sweden. Consequently, Skandia Sverige was assessed for being liable to output VAT under the reverse charge mechanism. Skandia Sverige appealed the decision before the Stockholm Administrative Court, which referred the following questions to the CJEU for a preliminary ruling:

- i. *First question:* Do supplies of 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?
- ii. *Second question:* If the answer to the first question is in the affirmative, is the main establishment in the third country to be viewed as a taxable person not established in the Member State within the meaning of Article 196 of the VAT Directive, with the result that the purchaser is to be taxed for the transactions?

4. THE CJEU'S JUDGMENT

4.1. First question

The final conclusion of the CJEU concerning the first question is that *"for VAT purposes, the services supplied by a company to its branch which belongs to a VAT group, are considered not to be supplied to that branch but must be regarded as being supplied to the VAT group. Inasmuch as the services provided for consideration by a company to its branch must be deemed, solely from the point of view of VAT, to have been provided to the VAT group, and 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"*⁴.

In order to assess whether a supply of services constitutes a taxable transaction subject to VAT pursuant to Articles 2(1) and 9 of the VAT Directive, the CJEU first analyses the legal relationship⁵ between the service supplier and the recipient.

In this respect, the CJEU states⁶ that Skandia Sverige does not operate independently and does not itself bear the economic risks arising from the exercise of its activity. In addition, according to the national legislation, the branch does not have any capital of its own and its assets belong to SAC. Consequently, the CJEU concludes that Skandia Sverige is dependent on SAC and cannot therefore itself be characterised as a taxable person within the meaning of Article 9 of the VAT Directive.

⁴ *Skandia America*, paragraphs 30 and 31.

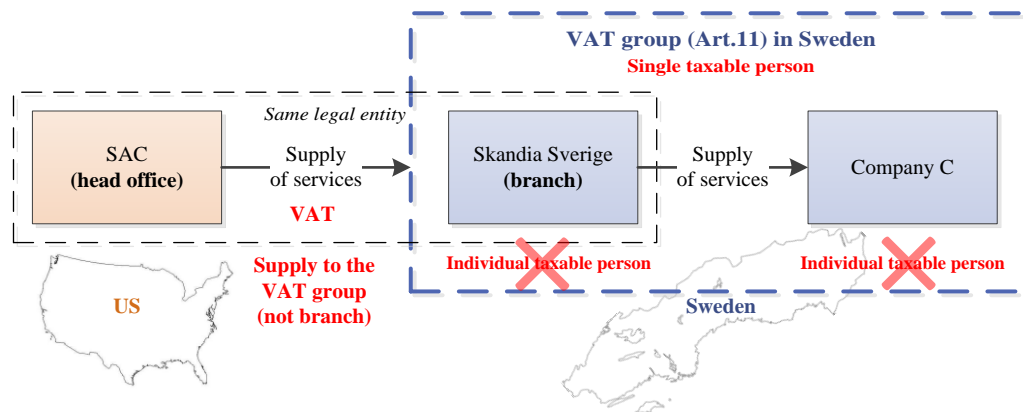
⁵ Article 2(1) of the VAT Directive states that, inter alia, the supply of services for consideration within the territory of a country by a taxable person acting as such is to be subject to VAT. In turn, Article 9 of the VAT Directive defines "taxable person" as any person who carries out any economic activity independently. Hence the legal relationship between SAC and Skandia Sverige in terms of economic dependency must be assessed in order to determine the existence of a taxable person and whether the supply is subject to tax.

⁶ *Skandia America*, paragraphs 21 to 26.

Further, the CJEU indicates, following the criterion laid out in *FCE Bank*⁷, that the existence of an agreement on the sharing of costs is irrelevant, when such an agreement has not been negotiated between independent parties.

However, given that the branch belongs to a VAT group which for VAT purposes is a single taxable person independent from the head office of that branch, the supply of services would be taxable. Therefore, according to the criteria laid out by the CJEU, the services cannot be seen as services "internal" to a single taxable person, supplied "within" that single taxable person by its head office to a branch, but as services supplied by a company, SAC, to another taxable person, the VAT group. Since SAC does not belong to the VAT group, it must be concluded that the supply of such services constitutes a taxable transaction, under Article 2(1)(c) of the VAT Directive.

The CJEU finds⁸ in relation to Article 11 of the VAT Directive that a VAT group has to be considered a single taxable person; *i.e.*, as a consequence of the registration in a VAT group the branch is dissociated from its head office and becomes part of a new taxable person, which is the VAT group itself. Therefore, the supply of services by a non-EU head office to its branch located in the EU is liable to VAT where that branch is part of a VAT group where that branch is part of a VAT group.



The CJEU in this has entirely dismissed the view of the Advocate General (AG) who on this point stated⁹ that Article 11 of the VAT Directive must be interpreted as meaning that the branch of a company incorporated under the laws of a third country may not, independently of the head office, be admitted into a group of several companies considered a single taxable person for VAT purposes in the Member State in which the branch is established. The AG considered this conclusion to be consistent with *FCE Bank*, where it was stated that a branch was not a separate taxable person in relation to its head office.

The AG defended the view that the services taking place between the head office and its branch are not taxable transactions for VAT purposes, in contrast to the services that are supplied between the branch and its customers, both within and outside this group.

⁷ CJEU, judgment of 23 March 2006 in case C-210/04 *FCE Bank*.

⁸ *Skandia America*, paragraphs 28 and 29.

⁹ CJEU, opinion of Advocate General Wathelet of 8 May 2014 in *Skandia America*, point 79.

4.2. Second question

Concerning the second question, the CJEU concluded that "*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 the branch belongs to a VAT group in that Member State, that group becomes liable for the VAT payable to the extent that the VAT group as a whole is the purchaser of the services for VAT purposes*"¹⁰.

5. THE COMMISSION SERVICES' ANALYSIS

Article 11 of the VAT Directive contains the relevant provisions concerning VAT grouping within the EU:

"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 judgment of the CJEU in *Skandia America* confirms the position already taken by the Commission in its VAT Grouping Communication¹¹ concerning the consequences of joining a VAT group: that upon joining a VAT group the group member dissolves itself from any possible, simultaneously existing legal form and instead becomes part of a new separate taxable person for VAT purposes – namely, the VAT group. This was also confirmed by the CJEU in *Ampliscientifica*¹² and means that if a branch joins a VAT group, thereby forming part of a new taxable person, any services supplied to that entity by its foreign head office would be regarded for VAT purposes as supplies made to the VAT group, and therefore as supplies made between two separate taxable persons.

However, following the ruling in *Skandia America*, some concerns may arise as to the consequences of applying the VAT grouping provisions in the light of the judgment, including whether the conclusions attained by the CJEU are applicable in circumstances which differ from the case facts at hand. The following issues arising from *Skandia America* shall be the subject of analysis in this Working paper:

Parties to the transaction

- Whether the ruling should have an impact on supplies other than "head office to branch" (section 5.1.2).

Nature of the supplies

¹⁰ *Skandia America*, paragraph 38.

¹¹ 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 on the common system of value added tax (COM(2009) 325), see in particular sections 3.2 and 3.3.2.2

¹² CJEU, judgment of 22 May 2008 in case C-162/07 *Ampliscientifica*, paragraph 19.

- Whether apart from supplies of services, the doctrine established should also apply to supplies of goods (section 5.2.1).
- Whether the conclusions of the CJEU should only be applicable to bought-in supplies, or also to internally-generated supplies (section 5.2.2).
- Whether this could have an impact on the allocation of costs between entities of the same legal person (section 5.2.3).
- Whether it could have an impact on cost-shared associations (section 5.2.4).

Territorial scope

- Whether the doctrine established should be applicable to scenarios other than "third countries to EU" supplies (section 5.3.1).
- Whether the conclusions of the CJEU could have an impact on the place of supply (section 5.3.2).

VAT grouping provisions as applied

- 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 not established in that Member State (section 5.4.1).
- Whether it could have an impact on businesses established in a Member State where the membership in a VAT group is automatic for entities under certain given circumstances (section 5.4.2).
- Whether it could have an impact in a Member State applying anti-avoidance provisions (section 5.4.3).
- Whether it could have an impact on businesses established in a Member State which does not apply VAT grouping provisions (section 5.4.4).

5.1. Parties to the transaction

5.1.1. Concepts

Firstly, for the sake of clarification, it may be relevant for the analysis at hand to briefly identify some concepts referred to in *Skandia America*, which are linked to the place of economic activity of a company (*e.g.*, head office and branch) and also concepts related to the ownership of a corporation (*e.g.*, parent company and subsidiary).

- *Related to ownership: “parent company”¹³ and “subsidiary”*

Despite the specific differences that may exist at national level, it is common understanding that where a company acquires a significant participation in the ownership of another business, it becomes the "parent company" – or "holding company" – of the latter. The company whose shares have been acquired by the parent company is referred to as "subsidiary".

¹³ Also referred to as "holding company".

– *Related to the economic activity of a company: "head office"¹⁴ and "branch"¹⁵*

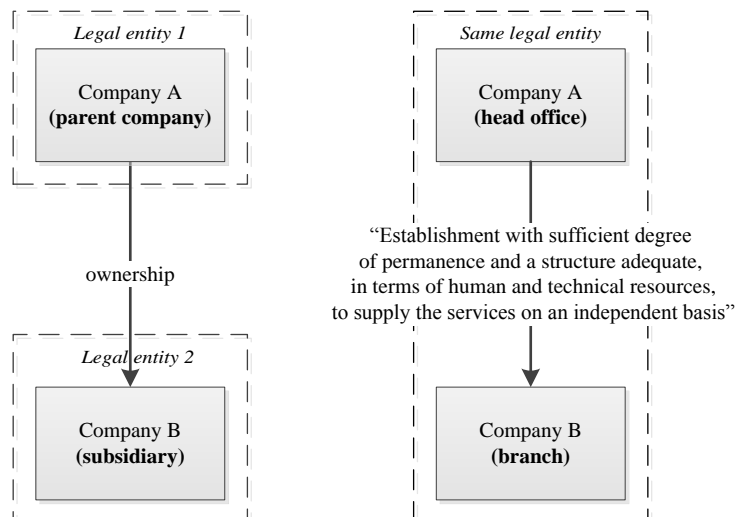
Such concepts relate to the economic activity carried out by a business.

"Head office" is commonly referred to as the principal establishment or the main establishment of a business, as can be seen in *Skandia America* with regard to SAC, which is the head office established in a third country. In the VAT Directive, several provisions refer to "place of business" or "place where the customer has established his business" for mentioning the same concept. In this sense, "place of business" has been defined by the CJEU as *"the place where the essential decisions concerning its general management are taken and where the functions of its central administration are exercised"*¹⁶.

On the other hand, "branch" is commonly referred to as the permanent establishment or the fixed establishment of a business. In terms of VAT, the CJEU has provided guidance on the meaning of "fixed establishment" for the purpose of determining the place of supply, making clear that *"an establishment must possess a sufficient degree of permanence and a structure adequate, in terms of human and technical resources, to supply the services in question on an independent basis"*¹⁷. This test has been codified in Article 11 of the VAT Implementing Regulation¹⁸.

– *Interaction between these concepts*

Although the concepts of "subsidiary" and "permanent establishment" might be used indistinctly in some cases, they respond to different parameters and need to be treated accordingly. The main difference is that whilst a parent company and a subsidiary remain different legal entities, a head office and its branch make up one and the same legal person.



¹⁴ Also referred to as "main establishment" or "place of business".

¹⁵ Also referred to as "fixed establishment" or "permanent establishment".

¹⁶ CJEU, judgment of 28 June 2007 in case C-73/06 *Planzer*, paragraphs 61 and 63.

¹⁷ CJEU, judgment of 17 July 1997 in case C-190/95 *ARO Lease*, paragraph 16.

¹⁸ 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.

In *Skandia America* it was in any event not called into question that the branch and the foreign head office constituted the same legal entity and the controversy mainly derived from this circumstance. Indeed, the facts of the main proceedings comprised the most challenging scenario conceivable, where the legal relationship between businesses clashed with their status as taxable persons under the VAT grouping rules.

5.1.2. Scope restricted to "head office to branch" supplies?

The facts in *Skandia America* comprised the supply of services from a head office to its branch. Since, in general, conclusions drawn by the CJEU are mostly case specific, it is appropriate to examine whether the rationale of the CJEU in this case could have an impact on supplies between entities other than "head office to branch".

Two aspects were taken into account: (i) on the one hand, the position laid out in the *FCE Bank*, whereby a branch and its head office which are the same legal entity should be treated as a single taxable person for VAT purposes, resulting in a supply of services between the two entities not falling within the scope of VAT; and (ii) on the other hand, the view that where the branch belongs to a VAT group thereby forming part of a new taxable person, the head office and its branch should not be considered to be the same taxable person for VAT purposes, even though they are legally bound to one another.

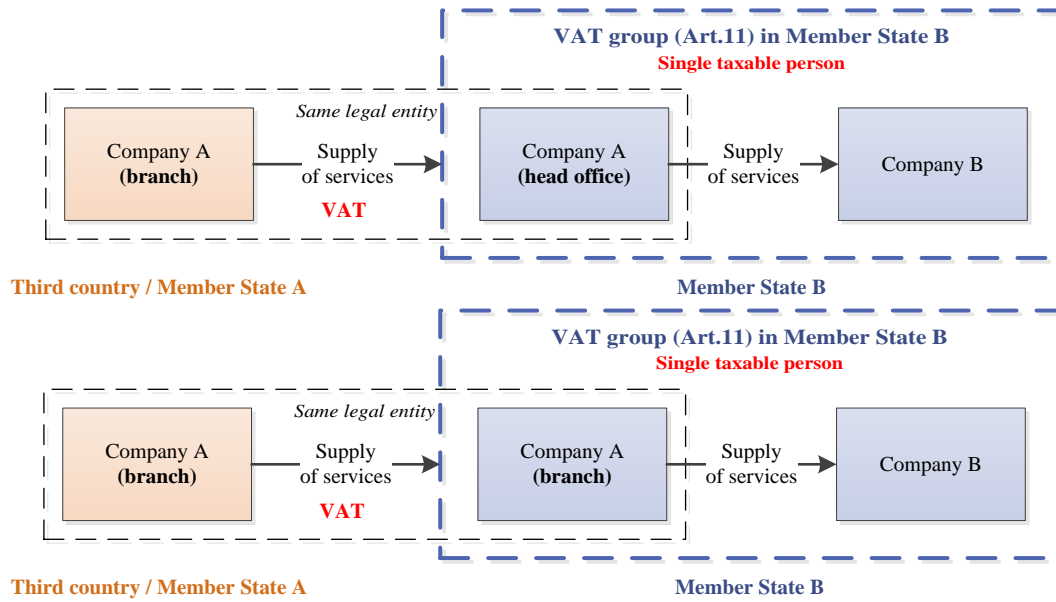
The CJEU confirmed in *Skandia America* that, even if businesses constitute the same legal entity, they may become separate taxable persons for VAT purposes where one of them belongs to a VAT group. Thus, VAT grouping provisions are given precedence over the legal ties between the entities. This should not be seen in contradiction with the conclusions in *FCE Bank*¹⁹.

Since the cornerstone of the judgment in *Skandia America* was the consideration of a VAT group and its members as a single taxable person, the reasoning of the CJEU seems applicable also in circumstances that differ from the facts of the case, such as: (i) supplies between entities (or rather establishments) of the same legal person, other than the "head office-branch" supplies at stake in the judgment; and (ii) supplies between entities which do not constitute the same legal person.

- i. Supplies between entities or establishments which constitute the same legal person other than those "head office to branch".

Such supplies would include, for example, supplies from a branch to its head office, or supplies between two branches.

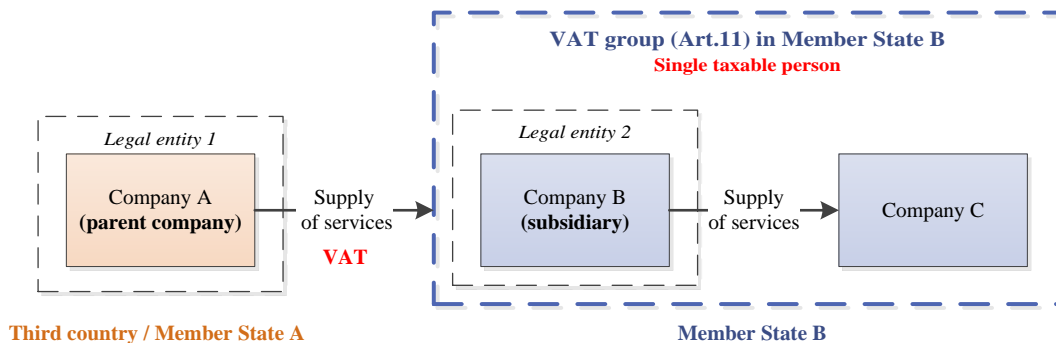
¹⁹ In *FCE Bank*, the relationship between the head office and its branch was not influenced by the presence of any VAT group.



As to the question of whether a branch could join a VAT group without its head office and the eventual need to respect the integrity of legal persons for VAT purposes, we refer to the analysis in section 5.4.1.

ii. Supplies between entities that are not the same legal person

It follows from *Skandia America* that if two businesses were not part of the same legal entity, there could be even more ground for treating them as separate taxable persons for VAT purposes if only one of them belongs to a VAT group, since the doctrine laid out in *FCE Bank* would not be applicable in such circumstances. This would be the case where supplies were made by a parent company to its subsidiary and vice versa.



5.2. Nature of supplies covered

5.2.1. Only provision of services or also supplies of goods?

In *Skandia America*, it was concluded that the supply of services by a non-EU head office to its branch located in the EU is liable to VAT where that branch is part of a VAT group. The question is whether the same conclusion could apply to supplies of goods between the entities.

Since in *Skandia America* the nature of the supply itself was not relevant, but rather the consideration as separate taxable persons of the supplier and the recipient of the services,

it seems that the conclusions attained in the case could be equally valid in cases involving a supply of goods for consideration.

This approach reiterates the position adopted in the VAT Grouping Communication, where it was stated that "*supplies of goods and services by third parties to one or more of the members of the group are considered to have been made to the group itself*"²⁰.

As a result of the judgment, some transactions which under the *FCE Bank* doctrine were considered beyond the scope of VAT could become taxable. For instance, the transfer of a right to dispose of tangible property as owner could become a supply of goods between two different taxable persons pursuant to Articles 2(1)(a) and 14(1) of the VAT Directive.

In other cases, it is unlikely that *Skandia America* could affect the VAT treatment of transfers of goods to any large extent.

A cross-border transfer of goods will typically result in either an importation of goods²¹ or in a supply of goods²². Such transactions, where carried out between two establishments of the same company, would normally be taxable irrespective of whether the entities are considered to be the same or different taxable persons.

Firstly, concerning the importation of goods, it is the physical entry of goods into the EU territory which leads to there being a taxable transaction, regardless of the parties. Secondly, as to the supply of goods, this taxable transaction could take place between two different taxable persons²³, or also between entities of the same legal entity or the same taxable person. In this respect, according to Article 17 of the VAT Directive, the transfer by a taxable person of goods forming part of his business assets to another Member State will normally be treated as a supply of goods for consideration.

As to the place of supply, we refer to section 5.3.2.

5.2.2. "*Bought-in*" supplies vs. *internally generated supplies*

The facts in *Skandia America* comprised a supply of services from the foreign head office to its branch in Sweden of "*externally purchased IT services*"²⁴. So, the question is whether the conclusions attained should apply only to services acquired from third parties or also to internally generated supplies.

In *Skandia America* and *FCE Bank*, that both involved a supply of services from a head office to its branch, when assessing the transfer itself, the CJEU did not explicitly take into account the characteristics of the supply, but rather looked at the relationship between the establishments.

Concerning *Skandia America*, the fact that the services had been externally-purchased by SAC from a third party could be seen as implying that the subsequent transaction between the head office and its Swedish branch was merely the passing of resources.

²⁰ VAT Grouping Communication, *op. cit.*, section 3.4.2.

²¹ Pursuant to Articles 2(1)(d) and 30 of the VAT Directive.

²² According to Articles 2(1)(a) and 14 of the VAT Directive.

²³ Subject to the requirements of Articles 2(1)(a) and 14 of the VAT Directive being met.

²⁴ *Skandia America*, paragraph 17.

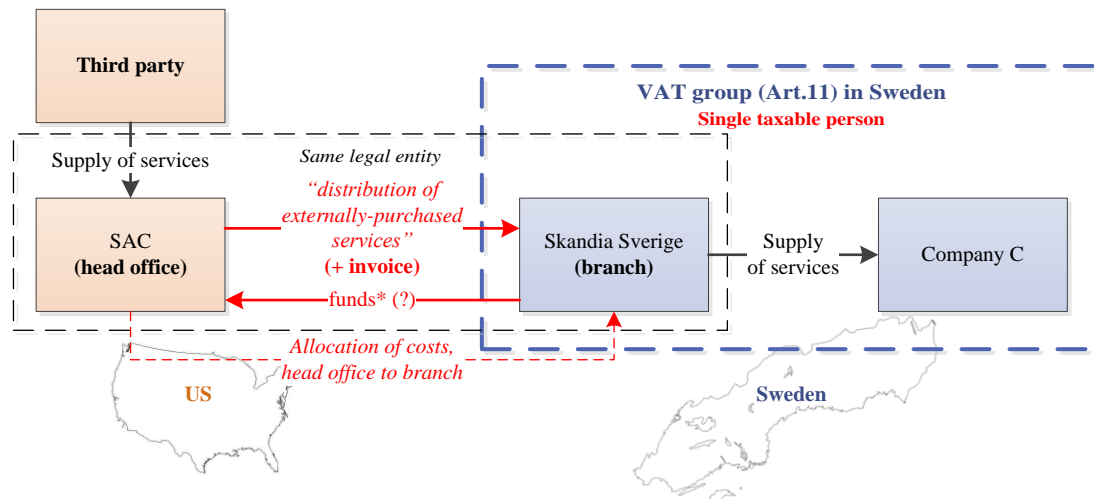
However, for determining if such distribution of services actually constitutes a taxable transaction, the circumstances under which the services are being supplied between the entities need to be examined on a case-by-case basis, in order to see if Article 2(1)(c) of the VAT Directive is applicable. If all the elements required by this article are present, notwithstanding that the transfer between the head office and the branch could be "merely" seen as the distribution of externally-purchased services, then the transaction would be subject to VAT.

The CJEU in *Skandia America* simply states that in a situation such as the one in the main proceedings, the head office and its branch belonging to a VAT group need to be treated as different taxable persons, thus leaving the door open for transactions between them being subject to VAT. It seems unfounded, though, to draw from this the conclusion that any transfer of externally-purchased services between entities such as those in the case is subject to VAT.

Concerning transfers of goods between entities of the same company, either externally purchased or internally generated, the requirements laid down in Article 2(1)(a), (b) and (d) of the VAT Directive need to be assessed on a case-by-case basis in order to determine if such transactions fall within the scope of VAT. In this respect, we must recall the comments made in section 5.2.1 concerning cross-border transfers of goods.

5.2.3. Allocation of costs

In the facts of *Skandia America*, the foreign head office centralised the purchase of IT services from a third party, which were then distributed to various entities of the group, including its branch in Sweden. An agreement existed for the sharing of costs – that were initially supported by the head office – between the foreign head office and the Swedish branch. Costs were allocated through the issuance of internal invoices.

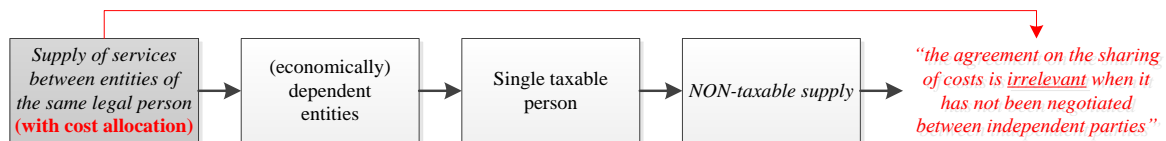


* The ruling does not specify whether funds were actually transferred from the branch to the head office in exchange for the services

Given the circumstances described, it is necessary to determine whether the distribution of externally-purchased services constitutes a taxable supply of services, *i.e.*, whether the cost allocation between the entities constitutes a consideration²⁵.

According to the reflections of the CJEU concerning the existence of a taxable supply, Article 2(1)(c) of the VAT Directive states that supplies of services effected for consideration within the territory by a taxable person acting as such are subject to VAT. "Taxable person" is defined as any person who "independently" carries out an economic activity, pursuant to Article 9(1) of the VAT Directive. In this respect, according to case-law, "a supply of services is taxable only if there exists between the service supplier and the recipient a legal relationship in which there is a reciprocal performance"²⁶. The legal relationship between the parties, in turn, depends on whether the branch carries out an independent economic activity.

The reasoning of the CJEU in *Skandia America* is in the first instance, and without taking into account the interaction of the case with VAT grouping provisions, consistent with the analysis in *FCE Bank*. Concerning the question of allocation of costs, the CJEU simply says in both judgments that since the two entities in the main proceedings are not economically independent and constitute one and the same taxable person, it is not possible for a transaction between them to be taxable (as a company cannot supply to itself). Therefore, the CJEU does not find it necessary to discuss whether the allocation of costs itself constitutes a consideration. This is also the reason why the CJEU does not answer the second question²⁷ tabled in *FCE Bank*.



The reasoning in *Skandia America* does not end at this point, but also takes into account the interaction with the relevant facts concerning a VAT group. As a result, the outcome of the case is that by joining the VAT group the branch dissociates itself from the head office for VAT purposes, becoming two different taxable persons even if they are still economically dependent upon each other, and the services between the head office and the branch are regarded as being taxable.

Some questions are left open; mainly, whether the cost allocation between two establishments of a company, where only the branch belongs to a VAT group, always

²⁵ The ruling does not specify whether funds are actually transferred from the branch to the head office for the purposes of the cost allocation between the entities. In this regard, however, we must recall that the existence of consideration does not necessarily depend on an eventual transfer of funds. For instance, see the concept of non-monetary considerations, as found by the CJEU in the case 230/87 *Naturally Yours Cosmetics*, judgment of 23 November 1988.

In the same way, not all transfers of funds between establishments of a company need to be the result of a cost allocation. In fact, some transfers of funds between establishments of a company could, for example, be the result of transfer pricing adjustments. Whether such an adjustment could qualify as consideration needs to be assessed separately.

²⁶ *Skandia America*, paragraph 24; and *FCE Bank*, paragraph 34.

²⁷ "Can the passing on of the costs of the costs of such service to the branch concerned be regarded as consideration for the services supplied for the purposes of Article 2, regardless of the proportion of the costs passed on and the resulting profit to the company?"

constitutes a consideration – and, therefore, the supply of services is taxable. Given that it is common practice of global businesses groups to source some services in a few specialised locations, this is a major issue that should be clarified.

In *Skandia America* it seemed undisputed that the cost allocation constituted consideration, with arguments of the parties rather being focused on the legal relationship between the entities involved.

Besides, considering that cost allocation did constitute consideration would seem to be the only possible assumption capable of leading to the conclusions attained by the CJEU in that specific case, especially when they are expressed in such strong terms²⁸. Otherwise, if the answer was that the supply of services with allocation of costs is not taxable, it would have been difficult to reach a general conclusion (that the supply is taxable) which contradicts the reality of the facts of the case from which the judgment derives.

It needs to be highlighted that the fact that a head office and the VAT group are to be treated as different taxable persons in the circumstances of *Skandia America* does not necessarily imply that any transaction between them must constitute a taxable transaction; in the same way that not any transaction between two taxable persons is subject to VAT. In other words, the observation that "*a provision of services is taxable only if there exists between the service provider and the recipient a legal relationship with reciprocal performance*"²⁹ is a condition necessary but not sufficient, for the transaction being subject to VAT.

The CJEU in *Skandia America* simply states that in a situation such as the one in the main proceedings, the head office and a branch belonging to a VAT group need to be treated as different taxable persons, thus leaving the door open for transactions between them being potentially subject to VAT. So, to deduce from the judgment in *Skandia America* that any cost allocation between establishments of a company such as those in the case has to be seen as consideration seems a step too far.

Therefore, no general conclusions should be drawn from *Skandia America* in respect of cost allocation, but the circumstances under which a service is provided need to be assessed on a case-by-case basis.

A supply of services is a taxable transaction subject to all the conditions pursuant to Article 2(1)(c) of the VAT Directive being met, *i.e.*, only if there exists a "service provided for consideration by a taxable person acting as such".

²⁸ In this respect, see also HENKOW, O., KAJUS, J. and TERRA, B., *Commentary of the case C-7/13 Skandia America*, 2014, IBFD Tax Research Platform: "*The Court confirms its findings in FCE Bank that a cost allocation between branches of a company cannot constitute consideration, as they are within one entity, but at the same time finds that the transactions are taxable. It is not evident in what situations a transfer of funds, which cover costs and/or the payment of income taxes (and transfer pricing adjustments), shall be seen as consideration. (It may also be the case, in some situations, that no actual funds are transferred.) (...) In the present case, the Court did not have to discuss whether there was any consideration either, as the national court only asked whether there were "taxable transactions". Nevertheless, the answer to the second question in the case implies that the Court seems to be of the opinion that a consideration was present in the case at hand*".

²⁹ *Skandia America*, paragraph 24; and *FCE Bank*, paragraph 34.

In this regard, for example, in order to constitute a taxable transaction not only the head office and the branch need to constitute different taxable persons, as concluded in *Skandia America*, but the head office also needs to be "acting as such". Given that a taxable person is defined pursuant to Article 9 of the VAT Directive as any person who independently carries out in any place any economic activity, it follows that for a transaction between a head office and a branch to be taxable, the head office needs to be a taxable person acting as such, *i.e.*, performing an economic activity.

This is further confirmed by the CJEU in *Floridienne & Berginvest* concerning loan transactions between a holding company and its subsidiaries: "*Since Article 2(1) of the Sixth Directive excludes from the scope of VAT transactions in which the taxable person is not acting as such, loan transactions, such as those in point in the main proceedings, are subject to VAT only if they constitute either an economic activity of the operator...*"³⁰.

It also follows from Article 2(1)(c) of the VAT Directive that a supply of services needs to be effected "for consideration", in order to constitute a taxable transaction. In this respect, allocation of cost between entities of the same company could be seen as consideration.

Some guidance may be found in the case *EDM*³¹, which involved a consortium (EDM) of several companies³² that shared the costs³³ of a project. These costs were borne by the members of the consortium individually, and afterwards they did a settlement of accounts between the undertakings making up the consortium. Besides, according to the contracts of the consortium, each member had to contribute to the project with some non-remunerated contribution. The CJEU held concerning the operations carried out by the members of the consortium in accordance with the pre-defined share that, since they were not paid for, they did not constitute a taxable transaction. On the other hand, where the performance of more of the operations than the share thereof fixed by the said contract for a consortium member involved payment by the other members against the operations exceeding that share, those operations constituted a supply of services "effected for consideration" within the meaning of Article 2(1)(c) of the VAT Directive.

Having said so, in a scenario where the *FCE Bank* principle is the only reason for precluding there being a taxable transaction between two establishments of a company, if the supplier and the recipient then become different taxable persons – such as in *Skandia America* – it seems that the only possible outcome is that a transaction the cost of which is allocated falls within the scope of VAT.

Concerning cost-sharing agreements in the context of transfers of goods, the requirements laid down in Article 2(1)(a), (b) and (d) of the VAT Directive need to be assessed on a case-by-case basis in order to determine if such transactions are taxable. In this respect, we must recall the comments made in section 5.2.1 concerning cross-border transfers of goods.

³⁰ CJEU, judgment of 14 November 2000 in case C-142/99 *Floridienne and Berginvest*, paragraph 27.

³¹ CJEU, judgment of 29 April 2004 in case C-77/01 *EDM*.

³² These companies were different legal persons.

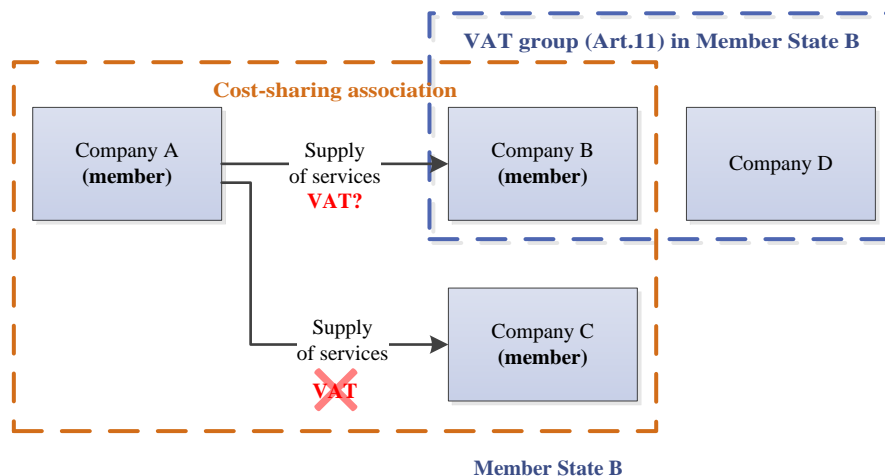
³³ More specifically, see *EDM*, paragraph 18: "*Invoices describing the operations to be carried out and stating their costs are issued by each of the undertakings which are members of the consortium and sent to its manager, namely EDM. Those invoices are used solely for subsequent settlement of the accounts between the undertakings making up the consortium, in accordance with the percentages for sharing of the expenses agreed in each consortium contract*".

5.2.4. *Interaction with cost-sharing associations*

Article 132(1)(f) of the VAT Directive contains an exemption³⁴ for the services rendered by cost-sharing associations to their members in order to allow economic operators to pool investments and re-distribute the costs associated to these investments from the group to its members without the burden of VAT.

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

The concept "independent groups of persons" is commonly referred to as a cost-sharing association; and the supply of services made under the conditions provided for under Article 132(1)(f) of the VAT Directive by such associations to their members would typically be exempt. Questions may arise as to the VAT treatment in a scenario such as the one presented below, where the services are supplied to a member of the cost-sharing association which, in turn, also belongs to a VAT group.



In this regard, we must refer to the opinion already expressed by the Commission in its VAT Grouping Communication: *"As concepts, cost sharing arrangements are in fact totally different from the VAT group concept, as they do not, for instance, have the effect of creating a new single taxable person"*³⁵.

It is clearly so that the VAT group creates a new single taxable person and that its members can no longer be treated individually in respect of supplies to or from third parties. Therefore, for VAT purposes, and referring to the scenario presented in the drawing above, it could not be possible for company B to individually be a member of the cost-sharing association. At this point, the question is however whether the VAT group in its entirety could be seen as a member of a cost-sharing association.

³⁴ For a more detailed analysis concerning this exemption, see Working papers Nos 450 and 654 of the VAT Committee.

³⁵ VAT Grouping Communication, *op. cit.*, section 2.

Article 132(1)(f) of the VAT Directive does not seem to exclude the possibility that a VAT group, which is a single taxable person for VAT purposes, as a whole becomes a member of a cost-sharing association, taking into account that the exemption is granted to "supplies of services by independent groups of persons". The fact that a VAT group is a taxable person which may contain more than one legal entity should not be seen as problematic.

Having said so, it must be underlined that the conditions established in the VAT Directive concerning the members of the cost-shared associations would need to be fulfilled by the VAT group as a whole.

Since a VAT group may be engaged in activities of diverse nature, one of the conditions that needs to be carefully assessed concerns the activities carried out by a member of a cost-sharing association. Article 132(1)(f) of the VAT Directive states that the members of the cost-sharing association must carry on "*an activity which is exempt from VAT or in relation to which they are not taxable persons*". As pointed out in Working paper No 654, in the absence of any indication that the exemption is for the use only of groups whose members carry on exclusively exempt or non-taxable activities, the Commission services are of the opinion that there is no basis for such a restriction.

If the conditions laid out in Article 132(1)(f) are not met by the VAT group as a whole, it could not become a member of a cost-sharing association.

5.3. Territorial aspects

5.3.1. Scope restricted to "third countries to EU" supplies?

Since the case facts in *Skandia America* comprised services supplied from a head office established in a third country to its branch in a Member State, it is appropriate to examine from the territorial perspective whether the rationale of the CJEU would also apply in other scenarios.

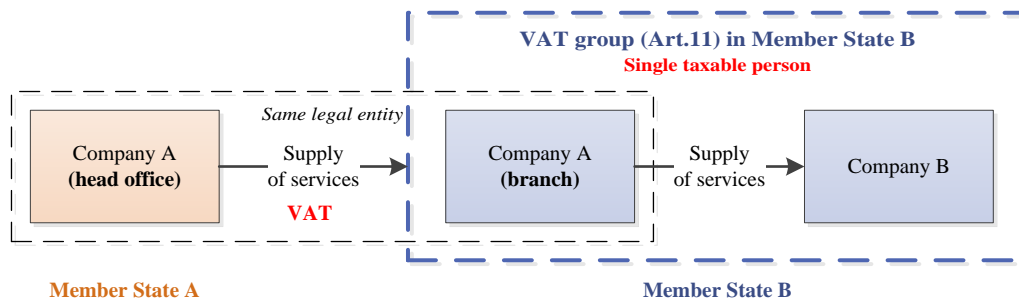
In *Skandia America*, the circumstances of the case did not strictly involve territorial issues, but was rather focused on arguments concerning the relationship between the entities: (i) on the one hand, the position laid out in *FCE Bank*, whereby a branch and its head office which are the same legal entity should be treated as a single taxable person for VAT purposes, resulting in a supply of services between the two establishments not falling within the scope of VAT; and (ii) on the other hand, the reasoning that where the branch belongs to a VAT group thereby forming a new taxable person, the entities should be considered independent taxable persons for VAT purposes even if they are legally bound to one another.

So, the fact that the head office was established in a third country and that the branch was established in Sweden was itself unessential, but the analysis revolved around the links between entities in legal and VAT grouping terms. In fact, the conclusions by the CJEU stem from considering a VAT group to be a single taxable person, which breaks any pre-existing ties with non-members of that VAT group, even if they are legally related entities. For VAT purposes, those non-members are considered to be outsiders of the group or, following the terminology of the CJEU, "third parties".

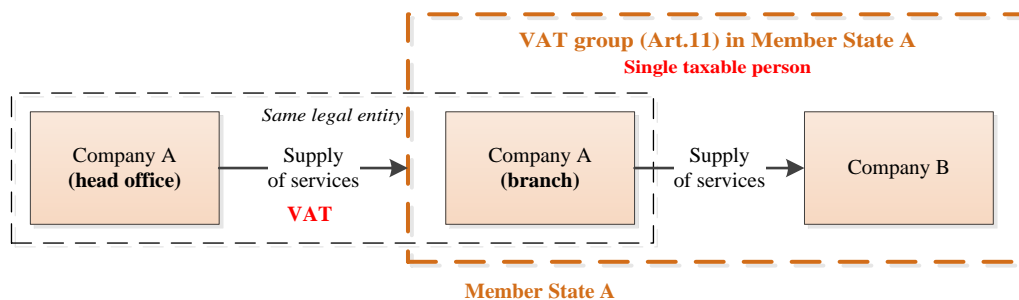
From the reasoning above, it seems that the conclusion attained in *Skandia America* should not be different had the head office been established in another Member State. Even if all the entities involved were established in one and the same Member State, where the head office does not belong to the VAT group, it should be treated as an independent taxable person different from the VAT group.

Therefore, it seems that the conclusion of the CJEU in *Skandia America* would not be different at least in the following scenarios:

i. Supplies of services between two Member States



ii. Supplies of services within one and the same Member State



Neither does the CJEU seem to give relevance to the direction of the supply of services, *i.e.*, whether the services are provided from a third country to a Member State or vice versa. In this case, the VAT treatment of an eventual supply of services from a VAT group established in a Member State to a company established outside the EU should follow the rules on the place of supply of services contained in the VAT Directive.

This all assumes that only persons "*established in the territory of a Member State*" can join a VAT group in that Member State, according to Article 11 of the VAT Directive. Concerning the interpretation of such provision in a scenario where only the branch of a foreign head office belongs to a VAT group in a Member State applying VAT grouping provisions, we refer to section 5.4.1.

5.3.2. *Place of supply derived from Skandia America*

i. Supply of services

It may be necessary to clarify the implications of *Skandia America* as concerns the place of supply of the service, as the place-of-supply rules are dependent upon the concepts of "head office" and "branch".

The place where a supplier or a customer has established his business or has a fixed establishment is decisive in determining the place of supply of services. The VAT Directive refers to the concepts³⁶ of head office ("place where a taxable person has established his business") or branch ("fixed establishment"), among others, in Article 44: *"The place of supply of services to a taxable person acting as such shall be the place where that person has established his business. However, if those services are provided to a fixed establishment of the taxable person located in a place other than the place where he has established his business, the place of supply of those services shall be the place where that fixed establishment is located"*.

In *Skandia America*, the CJEU concluded that the VAT group should be treated as a single taxable person for VAT purposes. Given that the branch belongs to the VAT group in Sweden without its head office, the question is whether this implies that the VAT group as a whole is to be seen as the branch. This is equally valid³⁷ for supplies other than "head office to branch". For example, concerning "branch to head office" supplies, if only the head office belonged to a VAT group without its branch, the question is whether the branch would then become a branch of the whole VAT group. If so, some could perhaps consider that the conditions for being considered a head office or a branch are not met by the VAT group as a whole, thus affecting the place of supply of the services and the VAT treatment of the transaction.

The conclusion of the CJEU in *Skandia America* does not, however, seem to imply that, in those circumstances, the whole VAT group could be seen as the branch of the foreign head office. Had that been the case, the doctrine of *FCE Bank* to which the CJEU explicitly refers would have been applicable, thus leading to regard the foreign head office and its branch (and with it the whole VAT group) as one and the same legal entity. That would imply the supply of services falling outside the scope of VAT, which differs from the conclusions reached.

In the same line, and concerning the mini One Stop Shop (MOSS), the Commission took the view³⁸ that a fixed establishment separates from the VAT group: *"If a member of the VAT group has, or will have, a fixed establishment in another Member State, the ties with that fixed establishment are broken for mini One Stop Shop registration purposes, and the supplies from that fixed establishment cannot be declared on the mini One Stop Shop VAT return of the VAT group"*.

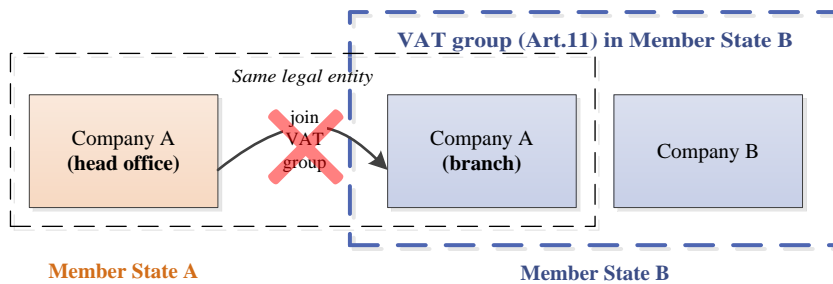
However, even if it were to be argued that the VAT group as a whole is the branch, this fact would not affect the VAT treatment of the transaction from the place-of-supply perspective for the following reasons.

³⁶ As to the meaning of these concepts, we refer to section 5.1.1.

³⁷ This reasoning could not be applied to parent companies or subsidiaries, which reflect a company status in terms of legal ownership, beyond the sphere of VAT. So, if the subsidiary company joined a VAT group without its parent company, this could not mean the VAT group becoming the subsidiary as a whole.

³⁸ Guide to the VAT mini One Stop Shop issued by the Commission (2013), p. 10 http://ec.europa.eu/taxation_customs/resources/documents/taxation/vat/how_vat_works/telecom/one-stop-shop-guidelines_en.pdf

Firstly, if the territorial scope³⁹ of Article 11 of the VAT Directive is respected, only businesses physically present in the territory of a Member State implementing the VAT grouping scheme should be able to join a VAT group there. Bearing in mind this territorial restriction, the question of whether it is the member of the VAT group, or the VAT group as a whole that needs to be considered to be the head office or branch, becomes meaningless from the point of view of the place of supply. That is the case because the place where the members of the VAT group are physically established will coincide with the territory of the Member State where the VAT group is created.



In the second place, as to the requirements for being considered a head office or a branch for VAT purposes, the VAT group would profit from the fact that one of its members fulfils the applicable conditions. Therefore, if a member of a VAT group individually met the conditions⁴⁰ for being considered a fixed establishment of a company, the VAT group as a whole would also fulfil these conditions.

ii. Supply of goods

It may be also worth making a reference to the rules governing the place of supply of goods, in connection with the judgment in *Skandia America*.

The rule to apply will in each scenario be dependent upon the existence of a taxable transaction and its characteristics. As previously pointed out, in this context not only the conclusions attained by the CJEU in *Skandia America* concerning taxable persons need to be taken into account – the VAT group member becomes for VAT purposes part of a new separate taxable person – but also the requirements of Article 2 of the VAT Directive which must be met for there to be a taxable transaction.

For the sake of clarification, there could be several types of taxable transactions concerning goods: (i) supply of goods; (ii) intra-Community acquisition of goods; or (iii) importation of goods, depending on the characteristics of the transaction. The place of supply rules would apply accordingly. A key issue that needs to be taken into account is whether the goods supplied are dispatched or transported.

Intra-EU supplies: It could be that a head office established in a Member State supplies goods to its branch located in another Member State, with that branch being part of a VAT group. The VAT treatment of this supply involving two different taxable persons would then be as follows:

³⁹ For a detailed analysis on this issue, see section 5.4.1.

⁴⁰ Article 11 of the VAT Implementing Regulation.

5.4. VAT grouping provisions as applied

5.4.1. Related entities not physically present in the Member State applying VAT grouping provisions, allowed as members of VAT groups

Article 11 of the VAT Directive restricts the territorial scope of a VAT grouping scheme implemented by a Member State to persons established in the territory of that Member State saying that: "...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...".

Therefore, it is essential to clarify whether a business is established in a Member State and how this territorial restriction should be interpreted in cases where the business physically present in the Member State implementing the VAT grouping scheme is the branch of a foreign head office.

Concerning this latter scenario, two approaches may be adopted:

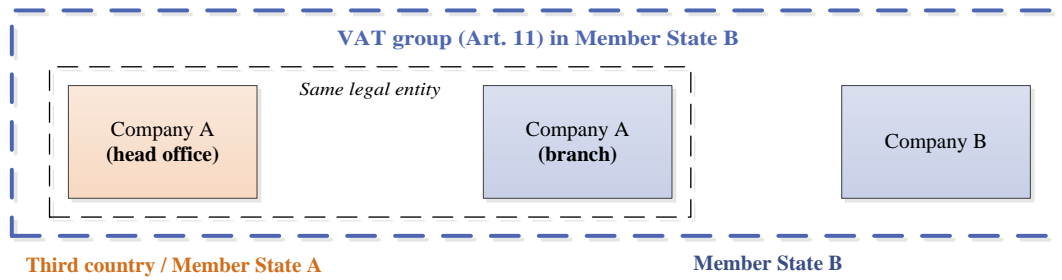
i. Interpretation 1: "Broad territorial scope"

Some may argue that a legal person comprising a head office and one or more branches may not lose its integrity, and that VAT grouping provisions could not separate its indissoluble legal relationship. Following this approach, some Member States may consider a business which is not physically present in its territory eligible for joining a VAT group, if the business is legally bound to a member of a VAT group physically present in the Member State. In other words, the business present in the territory of the Member State implementing the VAT grouping scheme would "attract" into the VAT group the related businesses outside that territory. Hence some may refer to these provisions as a "force of attraction"⁴¹.

This interpretation might be based on the conclusions of the CJEU in *FCE Bank*, whereby a branch and its head office which are the same legal entity should be treated as a single taxable person for VAT purposes, resulting in a supply of services between the two companies not falling within the scope of VAT. It should be kept in mind, however, that *FCE Bank* did not deal with the question of a VAT group.

Concerning the facts in *Skandia America*, according to this interpretation a company in its entirety may join a VAT group, *i.e.*, the foreign head office not physically present in the territory of a Member State could join a VAT group, provided that it has a branch physically present in that Member State.

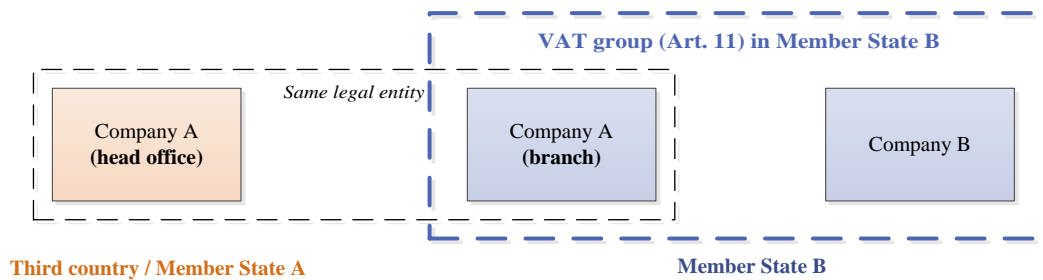
⁴¹ It is common understanding that the "force of attraction" principle refers to rules adopted by some countries in relation to the place of supply of services. In this Working paper, the expression is used as a means of better describing the reasoning behind interpretation 1.



ii. Interpretation 2: "Narrow territorial scope"

On the other hand, according to this narrow interpretation, the territorial scope of a VAT group should coincide with the VAT jurisdiction of the Member State implementing the VAT grouping scheme, thus restricting the membership in the VAT group only to businesses physically present in the territory, and regardless of their legal ties with other entities of the same company that may be physically present elsewhere.

Skandia America read in light of this approach would imply that a branch physically present in the territory of a Member State could be a member of a VAT group in that Member State on its own and without its head office, if the latter is in a third country or in another Member State.



iii. Assessment of these interpretations

Interpretation 1 resembles to a large degree the positions defended by some of the parties⁴² submitting observations before the CJEU in *Skandia America*. For them, the criteria laid out in *FCE Bank* leads to the result that a head office and its branch have to be treated as one single taxpayer, regardless of the existence of a VAT group. They considered that Article 11 of the VAT Directive does not confer to a Member State the right to artificially divide a head office and its branch (same legal entity) into two different taxable persons. This *FCE Bank* link between the two entities would thus remain unaffected by the fact that under Swedish law only the branch is considered to have joined a Swedish VAT group.

In contrast, other parties⁴³ defended in *Skandia America* that VAT grouping provisions should have the capacity to overturn the *FCE Bank* link between businesses and dissociate

⁴² SAC as well as the German and the United Kingdom governments (see *Skandia America*, points 26-38 of the opinion). It must be noticed that the positions were not completely coincident. While *Skandia America* Corporation and the German government considered that a branch can belong to a VAT group without its head office, the United Kingdom government denied this possibility.

⁴³ The Swedish government, the Swedish tax authority and the European Commission.

a branch from its head office, given the facts at hand. This implies a narrow approach on the territorial scope of Article 11 of the VAT Directive (interpretation 2).

The CJEU has never explicitly ruled on the territorial scope of VAT grouping provisions. Although it follows from the judgment in *Skandia America* that it is possible to exclude the head office placed outside the Member State applying the VAT grouping provisions from the VAT group (interpretation 2)⁴⁴, this fact does not necessarily imply that the CJEU undermines the validity of interpretation 1.

According to the provisions in the Swedish law, "*only the fixed establishment in Sweden of an economic operator may belong to a VAT group*"⁴⁵. Hence the outcome of the case could be seen in two different ways: either (i) Article 11 of the VAT Directive only admits one possible interpretation (interpretation 2) regarding the territorial scope; or (ii) both interpretations are equally valid, and *Skandia America* was solved applying the national rules of a Member State adopting interpretation 2.

In other words, the question is whether the conclusions drawn in *Skandia America* should be limited only to those Member States that, like Sweden, follow interpretation 2. To respond to this, the notion of "persons" and the territorial scope of Article 11 of the VAT Directive will need to be examined.

The notion of "persons"

Interpretation 1 strongly relies on the integrity of the legal entity. Some may find a support for this in the very wording of Article 11 of the VAT Directive, which refers to "persons": "*...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...*". Therefore, the legislation could be seen as not intending for the word "person" to refer to parts of legal persons.

This was the position defended by the AG in *Skandia America*: a "person" must be a legal entity and hence a branch could not, in itself, be a person entitled to be registered on its own as part of a VAT group. Instead, the "person" that could be registered in a VAT group would be the legal person as such. The AG considered this conclusion to be consistent with *FCE Bank*, as the conclusion in that case was that a branch was not a separate taxable person in relation to its head office.

The notion of "persons" has been interpreted in the VAT Grouping Communication⁴⁶ as only referring to "taxable persons". This position has been overruled by the CJEU in several cases⁴⁷, where it was stated that the inclusion of non-taxable persons in a VAT group is not contrary to the VAT Directive. However, it does not follow from the

⁴⁴ The CJEU did not venture in the direction considered by the AG (*Skandia America*, point 60), who expressed that a branch cannot be a member of a VAT group on its own and that the decision to register only the branch is contrary to Article 11 of the VAT Directive and thus illegal.

⁴⁵ *Skandia America*, paragraph 16.

⁴⁶ VAT Grouping Communication, *op. cit.*, section 3.3.1.

⁴⁷ CJEU, judgment of 9 April 2013 in case C-85/11 *Commission v. Ireland*; CJEU, judgment of 25 April 2013 in judgment C-74/11 *Commission v. Finland*; CJEU, judgment of 25 April 2013 in case C-65/11 *Commission v. Netherlands*; CJEU, judgment of 25 April 2013 in case C-95/11 *Commission v. Denmark*; CJEU, judgment of 25 April 2013 in case C-109/11 *Commission v. Czech Republic*.

conclusions of the CJEU that there needs to be an equivalence between "persons", be it taxable or non-taxable persons, and legal entities.

In fact, "taxable person" shall mean any person who, independently, carries out in any place any economic activity, according to Article 9(1) of the VAT Directive. Thus, for VAT purposes, what is ultimately relevant is the economic unit rather than the concept of a legal person. Such reasoning has been confirmed by the CJEU, for example, in *Heerma*, where it was concluded that a partnership with no legal personality could be considered a taxable person, distinct from its partners: "*it is the partnership, and not the partner or partners running the business, that (...) is to be considered as the taxable person*"⁴⁸. This seems to be in line with the position that a branch could be considered a taxable person (the VAT group), distinct from its head office.

It must be noted that the CJEU may have an occasion to re-examine the notion of "persons" and its membership in a VAT group in *Larentia + Minerva*⁴⁹.

The notion of "established" in the territory of a Member State

Although there is no guidance in the VAT Directive as to the notion of "established", it does not seem that Article 11 of the VAT Directive gives to Member States the possibility to choose between interpretation 1 or 2. The territorial scope of that provision should have a common and consistent approach throughout the EU and, as shall be seen, it does not seem to accommodate a broad territorial scope (interpretation 1).

According to the VAT Grouping Communication: "*established in the territory of that Member State' includes businesses with their seat of economic activity in the territory of the Member State implementing the VAT grouping scheme, but does not include those fixed establishments which are situated abroad. However, fixed establishments of foreign businesses situated in the territory of the Member State implementing the VAT grouping scheme must be included. Accordingly, only businesses with their seat of economic activity or fixed establishments of such businesses or of foreign businesses, physically present in the territory of the Member State that has introduced the VAT grouping scheme, may join a VAT group*"⁵⁰. That related the concept of "established" to the physical presence of a business in a territory, thus adopting a narrow territorial scope (interpretation 2)

Only entities (meaning establishments, either the head office or a permanent establishment of a company) physically present in a Member State should according to this be able to join a VAT group in that Member State. This would include (i) the seat of economic activity of a business in that Member State; or (ii) fixed establishments, either of such businesses or of foreign businesses, as long as they are physically present in that Member State.

It follows that, for VAT purposes, a legal entity comprising a head office and its branch which are physically present in different territories may be dissociated; and only the entity physically present in the Member State having implemented the VAT grouping scheme may be eligible for joining a VAT group.

⁴⁸ CJEU, judgment of 27 January 2000 in case C-23/98 *Heerma*, paragraph 8.

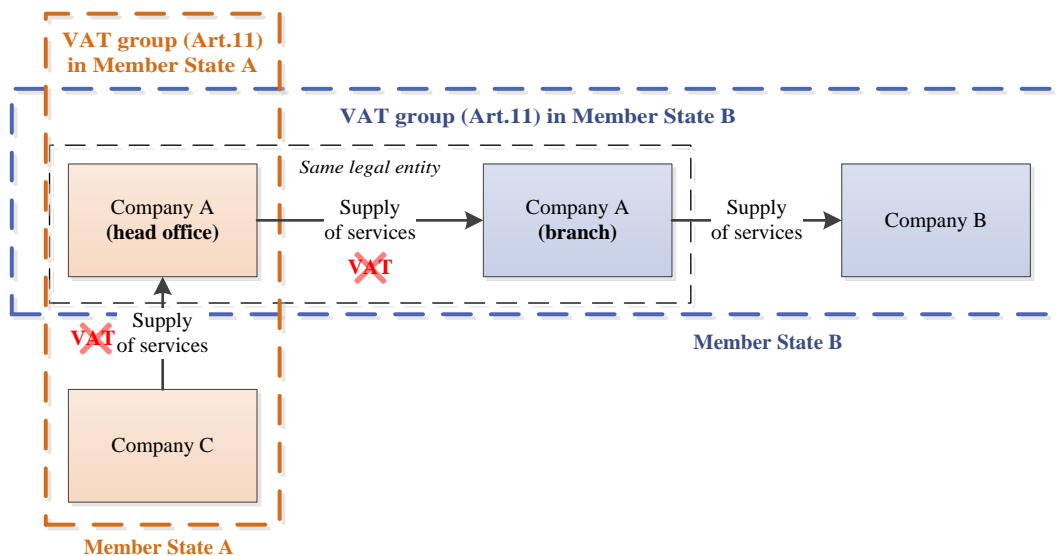
⁴⁹ CJEU, case C-108/14 *Larentia + Minerva*, pending before the Court.

⁵⁰ VAT Grouping Communication, *op. cit.*, section 3.3.2.1.

The VAT Grouping Communication already gave some arguments in support of this interpretation: (i) it is in line with the current wording of the territoriality criterion in Article 11 of the VAT Directive; (ii) the territorial scope coincides with the VAT jurisdiction of the Member State having implemented the VAT grouping scheme; and (iii) the notion of "established" within the meaning of Article 11 of the VAT Directive is used in other provisions of the Directive, and must be interpreted in the same way.

As stated in that Communication, it is so that *"since the VAT grouping scheme is an optional mode, chosen by one Member State, it should not have the effect of extending beyond the physical territory of the Member State which has introduced the VAT grouping scheme. Otherwise the fiscal sovereignty of another Member State may be infringed"*⁵¹.

A broad interpretation of the territorial scope (interpretation 1) could result in a business belonging to more than one VAT group, in different Member States. This creates the potential for "de facto" cross-border "EU VAT groups", something that is not provided for under the VAT Directive. In the case below, for example⁵², see a business ("company A") with its seat of economic activity in the territory of Member State A having adopted interpretation 2, which belongs to a VAT group in the same Member State. Besides, this "company A" has a branch physically present in Member State B, with which it constitutes a single legal entity. If Member State B adopted interpretation 1, the head office of "company A" would or could also be regarded as a member of the VAT group in Member State B.



Such a result is neither compatible with the basic principles of the common VAT system, nor manageable at national administration level. From the point of view of control, this is an unacceptable outcome that could also lead to unjustified tax opportunities.

⁵¹ VAT Grouping Communication, *op. cit.*, section 3.3.2.1.

⁵² The same outcome could occur if a foreign head office had branches established in several Member States adopting interpretation 1, where those branches belonged to a VAT group in their respective Member States.

Interaction with freedom of establishment

As to the territorial scope of Article 11 of the VAT Directive, it needs to be read in conjunction with the principle of freedom of establishment as set out in Article 49 of the Treaty on the Functioning of the European Union (TFEU)⁵³, as well as with Article 54 of the TFEU which enables fixed establishments of a foreign business to benefit from the same tax opportunities as those provided to businesses governed by national law in the Member State concerned.

It needs to be taken into account that settled case law of the CJEU only grants the freedom of establishment, "*so long as they do not encroach on the jurisdiction of other states*"⁵⁴.

Also concerning the principle of territoriality, some reflections in *Credit Lyonnais* are revealing and must be taken into account. In that case it was decided that a taxable person with a fixed establishment in another Member State or a third State is not permitted to take into account the turnover of that fixed establishment in calculating its deductible proportion of input VAT: "*No support can be drawn from either the preamble to the Sixth Directive or its substantive provisions for a finding that the fact that a taxable person has a fixed establishment outside the EU can affect the deduction system to which that taxable person is subject in the Member State in which its principal establishment is situated*"⁵⁵.

The fact that a head office and its branch are part of the same legal entity cannot imply that they are to be treated as an indistinct business. According to the CJEU: "*in a situation such as that at issue in the main proceedings, it cannot reasonably be argued that the services provided by fixed establishments outside the EU to customers also established in third States must be regarded as supplied by the principal establishment itself*"⁵⁶.

Some could argue that a company which has its principal establishment in a Member State and a branch in another Member State, for VAT purposes, should be taxed in the same way as a company, also established in that same Member State, which provides the same services without recourse to such a branch or which has, for that purpose, a subsidiary in another Member State. However, as said by the CJEU⁵⁷, the above reflect situations which are clearly different and cannot therefore be treated in the same way by the tax system.

In that regard, taxable persons are generally free to choose the organisational structures and the form of transactions which they consider to be most appropriate for their economic activities and for the purposes of limiting their tax burdens⁵⁸ and "*a trader's choice between exempt transactions and taxable transactions may be based on a range of factors, including on tax considerations relating to the neutral system of VAT*"⁵⁹.

⁵³ Consolidated Version of the Treaty on the Functioning of the European Union (OJ C 326, 26.10.2012).

⁵⁴ CJEU, judgment of 23 January 1986 in case 283/84 *Trans Tirreno Express*, paragraph 20.

⁵⁵ CJEU, judgment of 12 September 2013 in case C-388/11 *Le Crédit Lyonnais*, paragraph 43.

⁵⁶ *Crédit Lyonnais*, paragraph 44.

⁵⁷ *Crédit Lyonnais*, paragraph 45.

⁵⁸ *Crédit Lyonnais*, paragraph 46; and CJEU, judgment of 22 December 2010 in case C-277/09 *Deutschland Holdings*, paragraph 53.

⁵⁹ *Crédit Lyonnais*, paragraph 47; and CJEU, judgment of 9 October 2001 in case C-108/99 *Cantor Fitzgerald International*, paragraph 33.

As already pointed out in the VAT Grouping Communication⁶⁰, a narrow interpretation of the territorial scope would still allow fixed establishments of foreign businesses situated in the Member State having implemented the VAT grouping scheme to be included and benefit from the same tax opportunities as those provided to the businesses in that Member State, and will therefore be in line with the TFEU. The exclusion of the head office which is not physically present in the Member State from joining a VAT group there does not lead to inequality of treatment, compared to the VAT treatment of other businesses with their main seat of economic activity in the Member State, because the scenarios are different.

5.4.2. Automatic VAT group membership

Taking into account the domestic VAT grouping provisions, there seems to be a disparity of criteria among Member States as to the obligatory nature of membership in VAT groups. Therefore, while some Member States are of the opinion that (i) VAT grouping provisions should grant to potential group members the capacity to decide whether to join a VAT group or not; others think that (ii) the group members do not have the right to choose whether to use group taxation or not.

In this regard, reference must be made to Working paper No 813, where this question arose. Germany asked for the view of the VAT Committee whether Member States making use of Article 11 of the VAT Directive are then allowed in their national legislation to provide for an option that leaves it up to possible group members to decide whether or not to apply the VAT group scheme.

According to this Working paper, there are a number of provisions in the VAT Directive where Member States are explicitly empowered to provide for in their national legislation certain options to be exercised by operators. As a common feature, those provisions make use of a specific wording such as "*Member States shall allow...*"⁶¹ or "*Member States may allow...*"⁶². In contrast, those Articles of the VAT Directive which do not contain such explicit wording but rather leave it in the hands of Member States to take up an option (that is the category to which Article 11 belongs), cannot provide a legal basis for Member States to establish in their national legislation an option to be exercised by the operators concerned. Hence, the view taken was "*that Member States making use of Article 11 of the VAT Directive are not allowed to provide for in their national legislation an option for possible group members to decide to become part of a VAT group*".

If that view stands, then all potential VAT group members fulfilling the conditions set out in Article 11 of the VAT Directive, would be automatically treated as a single taxable person. Under such circumstances, the consequences of the judgment in *Skandia America* could have immediate effect, since the creation of the VAT group would not depend on the will of its members.

In other words, a branch in the same scenario as the one of the main proceedings could then have no other choice but to automatically merge into a new taxable person (the VAT group) and dissociate for VAT purposes from its foreign head office with which it shares legal personality. As a result, given that the treatment of the VAT group as a single

⁶⁰ VAT Grouping Communication, *op. cit.*, section 3.3.2.1.

⁶¹ See Articles 213(1), 220a(1), 223, 250(2), 261(2), 263(2), 348 and 350 of the VAT Directive.

⁶² See Articles 137, 204, 223 and 349(1) of the VAT Directive.

taxable person precludes its members from being identified as individual taxable persons within and outside their group, as confirmed by the CJEU⁶³, supplies of services between the VAT group and another taxable person would inevitably become taxable if all the conditions laid out in Article 2 of the VAT Directive were met.

However, Article 11 of the VAT Directive must be interpreted in the light of the original objectives. According to the Explanatory Memorandum⁶⁴ and, as the CJEU has recalled, "*the European Union legislature intended, either in the interests of simplifying administration or with a view to combating abuses such as, for example, the splitting-up of one undertaking among several taxable persons so that each might benefit from a special scheme, to ensure that Member States would not be obliged to treat as taxable persons those whose independence is purely a legal technicality*"⁶⁵.

It follows that a group of persons could be regarded automatically as a single taxable person where close financial, economic and organisational links exist between them on the grounds of combating abuses.

But it is nonetheless true that Article 11 of the VAT Directive can also be used for administrative simplification purposes, as recognised by the CJEU. In such circumstances, it seems that the application of VAT grouping rules would not need to be automatic.

5.4.3. Use of anti-avoidance provisions

According to the second paragraph of Article 11 of the VAT Directive, "*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*", commonly referred to as anti-avoidance or anti-abuse provisions. This option is in line with the settled case-law⁶⁶ of the CJEU, whereby Member States are empowered to combat abusive practices.

As already pointed out in the VAT Grouping Communication⁶⁷, it is important that Member States make use of this option and take all necessary measures to avoid abusive practices, carried into effect through the use of their national VAT grouping schemes, since no unjustified advantage or harm should arise from the implementation of the VAT grouping option.

However, not all Member States implementing the VAT grouping scheme have foreseen explicit anti-avoidance provisions in their legislation and even if such provisions have been adopted, their content is not harmonised.

The fact that the adoption of anti-avoidance provisions is at the discretion of Member States could perhaps be seen as making it difficult to draw general conclusions concerning the application of the criteria in *Skandia America* as far as those Member States applying such measures are concerned.

⁶³ *Ampliscientifica*, paragraph 19.

⁶⁴ Explanatory Memorandum to the proposal which resulted in the adoption of the Sixth Directive (COM(73) 950) concerning Article 4(4) of the Sixth Directive, which was replaced by Article 11 of the VAT Directive.

⁶⁵ *Commission v. Ireland*, paragraph 47.

⁶⁶ CJEU, judgment of 21 February 2006 in case C-255/02 *Halifax*, paragraph 70.

⁶⁷ VAT Grouping Communication, *op. cit.*, section 3.5.3.

Irrespective of any anti-avoidance provisions being used, it seems nonetheless clear that supplies of services from the head office to its branch, where the latter belongs to a VAT group, should remain taxable transactions if the conditions laid out in Article 2(1)(c) of the VAT Directive are met.

Such conclusion mainly stems from the analysis carried out in relation to the treatment of entities not physically present in a Member State applying VAT grouping provisions (see section 5.4.1) and the nature of the supplies (sections 5.2.2 and 5.2.3).

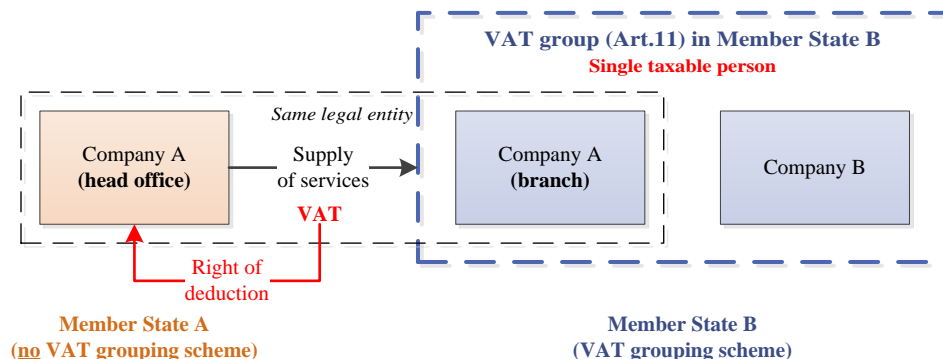
5.4.4. No VAT grouping provisions applied

The adoption of the VAT grouping scheme provided in Article 11 of the VAT Directive is in the hands of the Member States.

As explained in section 5.4.1 in more detail, Article 11 of the VAT Directive restricts the territorial scope of a VAT grouping scheme implemented by a Member State to persons established in the territory of that Member State, which should be understood as referring to entities physically present in a Member State. That way, the territorial scope of this Article coincides with the VAT jurisdiction of the Member State having implemented the VAT grouping scheme.

Having said so, it seems clear that also Member States without domestic VAT grouping provisions could be affected by the existence of VAT groups in other Member States, particularly in respect of the tax treatment of supplies made between entities that make up part of the same legal person. This side effect is empowered by the judgment of the CJEU in *Skandia America*, since certain transactions that had been seen as falling outside the scope of VAT by virtue of the *FCE Bank* link are regarded by the CJEU as taxable transactions.

For example, according to the judgment in *Skandia America*, supplies of services from a head office established in a Member State without VAT grouping provisions to its branch in another Member State having implemented the VAT grouping scheme are taxable, where the branch belongs to a VAT group. In order to ensure fiscal neutrality, the head office making a taxed supply would need to be granted the right of deduction, even if the Member State where that head office is established had chosen not to exercise the option provided by Article 11 of the VAT Directive.



Therefore, head offices or branches established in countries without VAT grouping provisions could become suppliers or recipients of taxable services, even if this is only the result of another Member State applying a VAT grouping scheme.

5.5. Final considerations

The CJEU found in the case *Skandia America* that supplies of services by a non-EU head office to its branch located in a Member State having implemented the VAT grouping scheme pursuant to Article 11 of the VAT Directive, where that branch is part of a VAT group, are taxable transactions subject to VAT.

At this point, it is necessary to elucidate whether this conclusion is applicable in circumstances other than those of the facts of the main proceedings, bearing in mind that the conclusions of the CJEU stem from one main idea: upon joining a VAT group, the group member dissolves itself from any possible, simultaneously existing legal form to become, for VAT purposes, part of a new separate taxable person— namely, the VAT group.

Since VAT grouping provisions are given precedence over the legal ties between the entities, it follows that the conclusions attained in *Skandia America* would also be applicable in transactions other than "head office to branch", where only one of the entities involved in a transaction is a member of a VAT group.

As to the nature of the supplies, the fact that in *Skandia America* the taxable transaction was a supply of services seems incidental to the main proceedings. Concerning cross-border transfers of goods, it is unlikely that the reasoning in *Skandia America* with regard to the existing taxable persons could affect to a large extent its VAT treatment. Such transactions, where carried out between two establishments of the same company, would normally be taxable⁶⁸ irrespective of whether the entities are considered to be the same or different taxable persons. Also the origin of the supply – the fact that the goods or services are externally or internally generated – seems to be a nonessential aspect *per se*, since application of VAT needs to be assessed in light of Article 2(1) of the VAT Directive.

Concerning the allocation of costs between entities, whilst the CJEU did not examine this facet of the question, it seems a step too far to deduce from *Skandia America* that any supply of services with cost allocation between entities such as those in the case is subject to VAT. Cost allocation between entities could only be seen as consideration for a transaction, rendering it taxable, if all the conditions pursuant to Article 2(1)(c) of the VAT Directive are met.

In respect of cost-sharing associations, it seems possible that a VAT group, which is a single taxable person for VAT purposes, could become a member of a cost-sharing association pursuant to Article 132(1)(f) of the VAT Directive but only if the whole VAT group is integrated.

As regards the territorial scope of the case, the conclusions attained in *Skandia America* should not be different with regard to supplies within the same Member State, or between two Member States, given that the cornerstone of the judgment is that a VAT group becomes a separate taxable person.

The place where a supplier or a customer has established his business or has a fixed establishment is decisive in determining the place of supply of services. In this respect, the conclusion of the CJEU in *Skandia America* does not seem to imply that, in those

⁶⁸ A cross-border transfer of goods will typically result in an importation of goods or in a supply of goods.

circumstances, the whole VAT group could be seen as the branch of the foreign head office. Therefore, the place of supply of any eventual transactions between the parties would remain unaltered.

As to membership in a VAT group, for the sake of the territoriality principle and the management of the VAT system, it should be restricted to establishments of companies physically present in the Member State applying the VAT grouping scheme. Therefore, the approach whereby a branch could belong to a VAT group without its foreign head office despite the fact that they are the same legal entity, as found in *Skandia America*, seems to be inherent to Article 11 of the VAT Directive.

Bearing in mind that one of the original purposes behind the introduction of the VAT grouping provisions was combating abuse, it seems that membership of a VAT group should not depend on the will of the members of the VAT group, but that they could be regarded as automatically forming a VAT group if closely bound to one another by financial, economic and organisational links. However, the CJEU has also recognised that Article 11 of the VAT Directive aims at simplifying administration, as indicated in the explanatory memorandum of the proposal for a Sixth VAT Directive, which may justify a non-automatic application of VAT grouping rules.

The fact that the adoption of anti-avoidance provisions is at the discretion of Member States could perhaps be seen as making it difficult to draw general conclusions concerning the application of the criteria in *Skandia America*. Irrespective of any anti-avoidance provisions being used, it seems nonetheless clear that supplies of services from the head office to its branch, where the latter belongs to a VAT group, should remain taxable transactions if the conditions laid out in Article 2(1)(c) of the VAT Directive are met.

It also follows from the conclusion in *Skandia America* that Member States not having implemented the VAT grouping scheme could face side effects associated with the recognition of VAT groups in other Member States, particularly in respect of the tax treatment of supplies made between entities that make up part of the same legal person.

6. DELEGATIONS' OPINION

Delegations are invited to express their views on the matters 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 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.
- j) Whether it 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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