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European Tax Law – VAT between a main company and a branch, where the branch belongs to a VAT group

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On 17 September 2014, the Court of the European Union (Second Chamber) gave its judgment on Case C-7/13 on a reference for a preliminary ruling concerning the Common system of value added tax – Directive 2006/112/EC – VAT group – Internal invoicing for services supplied by a main company with its seat in a third country to its branch belonging to a VAT group within a Member State.

In that judgment, the Court of the European Union ruled that supplies of services from a main establishment in a third country to its branch in a Member State constituted taxable transactions when the branch belonged to a group of persons whom it was possible to regard as a single taxable person for value added tax purposes.

In connection with the judgment on the reference for a preliminary ruling, the Court considered the following:

Where the branch is a member of a VAT group, created on the basis of Article 11 of the VAT Directive (Member States may exercise the option to introduce group value added taxation; Bulgaria does not have such legislation yet), the branch forms with the other members a single taxable person.

The requesting jurisdiction, the Swedish tax administration (Skatteverket), sought an answer to the question whether supplies of externally purchased services from a company's main establishment in a third country (the USA in this case) to its branch in a Member State, with an allocation of costs for the purchase to the branch, constituted VAT taxable transactions if the branch belonged to a VAT group in the Member State.

In other words, the question relates to the applicability of the principle outlined in the judgment in *FCE Bank* (EU:C:2006:196) in the cases, where the branch of a company established in a third country belongs to a VAT group in the Member State of its establishment. In that case, the Court ruled 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 the costs imputed to it in respect of those supplies*".

In accordance with the case law of the Court, supplies are taxable only if there exists a legal relationship between the provider and the recipient, in which mutual payments are made in

connection with the services for consideration. In order for such a relationship to be established between a non-resident company and a branch established in a Member State so that the supplies made be subject to VAT, it is necessary to determine whether the branch carries out an independent economic activity. It is necessary in this regard to determine whether the branch may be regarded as being *independent*, in particular in that it bears the economic risk arising from its business (judgment in *FCE Bank*, EU:C:2006:196, para 35).

In the course of the proceedings, observations were requested from and submitted by the German Government and Skandia America Corporation (USA) in its capacity of a party to the case. The two observations were in the sense that the principle of unity of the main company and the branch set out in the judgment in *FCE Bank* (EU:C:2006:196) applied also in cases in which the branch belonged to a VAT group. In their opinion, the VAT Directive does not give any right of Member States to artificially divide the main company and its branch into two separate taxable persons. The branch is not independent enough to act at its sole expense and in its name, as well as to bear itself the economic risks arising from the exercise of its activity so that to generate turnover between the main company and the branch for VAT purposes. In accordance with the considerations put forward in the judgment in *FCE Bank* (EU:C:2006:196), the branch does not itself bear the economic risks arising from the exercise of its activity and does not have any capital of its own. Skandia America Corporation points out that its branch in Sweden cannot itself be characterized as a taxable person for VAT purposes.

It is further indicated that the principle of unity of VAT groups applies only to the members of a group established in the Member State of the group. In the opinion of the German Government, the conclusion is that the internal supplies among the various legal entities within a VAT group are non-taxable for VAT purposes, insofar as they are limited in transaction involving only entities (including main companies) established in the Member State of the VAT group. Hence payments for services are taxable for VAT purposes, where a party to the transaction is an entity (including a main company) which is not established in the Member State of the VAT group.

The Government of the United Kingdom expressed its opinion that a branch itself could not participate in a VAT group. That opinion contravened the interpretation given in a Communication to the Council and the Parliament, stating that a VAT group could include the branches of non-resident companies established in the Member State where the VAT group was registered. Furthermore, the Government of the United Kingdom was of the opinion that the principle which the Court outlined in its judgment in *FCE Bank* (EU:C:2006:196) was applicable and that the supplies of services between the main company and the branch were non-taxable.

The Swedish tax administration (Skatteverket), the Swedish Government and the European Commission objected to that interpretation of the VAT Directive. Although they did

not challenge the principle laid down in the judgment in *FCE Bank* (EU:C:2006:196), Skatterverket, the Swedish Government and the Commission found it non-applicable in cases when only the branch was a member of a VAT group. Instead, they expressed their opinion that, *as a result of the accession of the branch to a VAT group*, by force of the principle of a single taxable person under Article 11 of the VAT Directive, *the branch no longer belonged to the same single taxable person as the main company*. As a result of the participation of the branch in a VAT group, there would be supplies of services between two taxable persons, i.e. the main company and the VAT group to which it belonged for VAT purposes.

The Court accepted and ruled that the supplies of services by a third party to a member of a VAT group could be regarded as supplies to the VAT group to which the member belonged rather than to the member itself for VAT purposes. Hence the services which the main establishment supplies for consideration to a branch should be regarded, only for VAT purposes, as provided to the VAT group and, insofar as they could not be considered a single taxable person, the supplies of these services should be deemed taxable under Article 2(1)(c) of the VAT Directive.

In that specific case, 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 group of persons whom it is possible to regard as a single taxable person for value added tax purposes in that Member State, that group, as the purchaser of those services, becomes liable for the value added tax payable.