VAT ALERT: CROSS-BORDER SUPPLIES OF SERVICES MADE TO VAT GROUPED BRANCHES

Skandia America Corp. (USA), filial Sverige (C-7/13)

For VAT purposes, a supply of services from the headquarters of a company to its branch is generally not subject to VAT. This is well-established, and was confirmed in the Court of Justice of the European Union (the **"Court of Justice"**) case of *FCE Bank C-210/04* (2006), where it was held that a branch could not be regarded as a separate economic person, where it does not operate independently, covers no economic risk and does not have capital assets of its own. Until now, this has meant that companies have been able to make cross-border supplies of services to their EU branches without having to charge VAT. However, that position looks set to become more complicated where such supplies are made to a branch which is a member of a "VAT group", following the preliminary ruling of the Court of Justice in *Skandia America Corp. (USA), filial Sverige* (C-7/13).

The facts of the *Skandia* case involved the supply by Skandia America Corp. (**"SAC"**), a US company without a fixed business establishment in the EU, of IT services purchased by SAC from a third party to SAC's Swedish branch, Skandia Sverige (**"SKS"**), that had joined a Swedish VAT group. SAC re-charged the costs of the externally purchased IT services to SKS with a 5% mark-up. SKS used these supplies to provide services to recipients both within and outside the VAT group. VAT was not applied to the costs charged by SAC to SKS. However, the Swedish tax authorities took the view that the cross-border supplies from SAC to SKS were subject to VAT in Sweden, and they therefore imposed a tax assessment on SKS. Skandia appealed the assessment, and the Swedish courts referred the matter to the Court of Justice.

Skandia argued that the supplies from SAC to SKS should be disregarded for VAT purposes as cross-border supplies of services from a company to its EU branch, under the principles established by EU VAT case law (see *FCE Bank*). However, the Court of Justice concluded that this was not the correct analysis and that instead the relevant supplies should be treated as standard -rated taxable supplies, in respect of which the Swedish VAT group of which SKS was a member (acting through its representative member) must account for VAT.

In reaching this conclusion, the Court of Justice considered the provisions of EU VAT law under which Member States may choose to regard as a single taxable person any persons established in that Member State who, while legally independent, are "*…closely bound to one another by financial, economic and organisational links*". This practice, of allowing a number of separate but related entities to be treated as a single person for VAT purposes, is known in the UK as "VAT grouping". A consequence of VAT grouping is that all of the supplies made by and to all of the members of the VAT group are treated, for VAT purposes, as if they were made by and to the VAT group as a single taxable person (acting through whichever of the member entities is designated as the representative member of the VAT group). Applying these provisions to Skandia's facts, the Court of Justice found that, as SKS was a member of a VAT group, SKS became part of a new legal entity for

VAT purposes, and could no longer be regarded, for this purpose, as part of the same legal person as SAC. Accordingly, the cross-border supply made by SAC to SKS was, for VAT purposes, not a supply made by SAC to its branch (ie SKS) which should be disregarded but was instead a supply by SAC to the VAT group of which SKS was a member. In the Court of Justice's view, such a supply of services by a non-EU business to a VAT group constitutes a taxable transaction on which VAT must be charged at the standard rate. The Court of Justice found that in those circumstances, where a supply of services is made by a non-EU company to a company established in the EU, the "reverse charge" mechanism applied, under which the representative member of the VAT group was liable to account for the VAT due.

COMMENT

The ruling of the Court of Justice in *Skandia* states that VAT must be accounted for at the standard rate on cross-border supplies of services made by a non-EU business to an EU branch if that branch is a member of a VAT group. The ruling is likely to mean that companies which previously were not charging VAT on services supplied cross-border by a "head office" to an EU branch may need to treat the services as supplied to the representative member of the VAT group, which will be required to account for VAT under the reverse charge. In short, the branch is no longer regarded as part of the same single legal person as the headquarters but solely as a member of the VAT group.

Businesses will be looking to see if they can increase the VAT recovery rate of the VAT group generally, and may consider de-grouping the branch. Certainly, if the ruling is applied, without further mitigation, there is no longer a VAT advantage in a head office buying-in services and recharging the costs to its EU branches, who form part of the local VAT group.

It should however be stated that there is nothing in the judgment which threatens the established principle that there is no supply by a headquarters to its branch, in a simple case, where the branch is not also part of a VAT group.

HMRC in the UK are expected to give their reaction to this case. In accordance with Value Added Act 1994 s.43(2A), where the recharged costs have been bought-in from a third party (or at least by concession where the cost of the bought-in services exceeds 5% of total recharge) the supply intra-group is already treated as a taxable self-supply by the representative member of the VAT group. Accordingly, HMRC have already dealt with the VAT avoidance arising from the combination of cross-border intra branch supplies and VAT grouping, in the context of bought-in services, by treating the intra-group transactions as a taxable supply, rather than treating the supply to the branch as taxable. It may be that HMRC decides that in view of this, it need not change its rules, as the main mischief has been covered.

The decision in *Skandia* could lead to affected businesses being faced with a significant VAT charge. The decision is likely to hit financial services companies, whose businesses are exempt and partially exempt, including banks and insurance providers, particularly hard, as these kinds of company often use branches to conduct overseas business and use VAT groups to minimize the VAT leakage on recharges. As a result of the ruling in *Skandia*, many businesses with EU branches may therefore need to look again at how they structure and allocate the costs of their cross-border intra-group supplies of services.

The ruling has come as a surprise to many observers, not least because it is contrary to the Opinion issued in May by the Advocate General, in which the Advocate General opined that a branch cannot be considered as a VAT-group member independent from its head office. Although the ruling deals specifically with supplies made by non-EU companies to their branches within the EU, as those were the facts with which the Court of Justice was presented, it appears to be of potentially wider application, so that it could also affect supplies made between a company in one EU Member State and a branch of that company in another Member State, albeit that in the context of avoiding VAT on bought-in services, the mischief generally involves jurisdictions outside the EU recharging costs into EU branches.

To find out more, please contact:

Richard Woolich
Partner (Head of UK Tax)
T +44 20 7153 7336
richard.woolich@dlapiper.com

Jonny Gordon
Associate
T +44 20 7796 6417
jonathan.gordon@dlapiper.com