VAT AND THE TAXABLE PERSON

A new identity crisis

If tax is a foreign country, then VAT is a foreign country in a parallel universe where everything needs to be translated: transactions become "supplies", and taxpayers become "taxable persons". Of course, if it were simply a case of labels, no one would worry.

However, the European Court of Justice (ECJ) has recently highlighted that there is more to a taxable person than just a different name, holding that transactions between a branch and its main establishment located in a non-EU member state were taxable for VAT purposes (*Skandia America Corp (USA), filial Sverige v Skatteverket C-7/13; see News brief "Multinationals and VAT groups: an unwelcome conclusion", www.practicallaw.com/4-584-9613*).

The meaning of taxable person

The concept of a taxable person for VAT purposes is not restricted to entities with legal personality, such as a natural or legal person, so a partnership that does not have a separate legal personality can be a taxable person. In addition, a group of companies, each with its own distinct legal personality, can be a single taxable person (a VAT group).

A VAT group does not just confer administrative or substantive benefits (such as simplified filing or tax relief), it creates the fiction (unusual in the UK at least) that the group is a single person. Supplies between members of a VAT group become supplies within the same taxable person and so are normally disregarded for VAT purposes.

The position of branches

Where a company operates in multiple locations (whether in the same jurisdiction or otherwise), it is generally accepted that its branches are simply extensions of the same legal person.

In *Ministero dell'Economia e delle Finanze, Agenzia delle Entrate v FCE Bank plc*, the ECJ sensibly confirmed that, because the branch was not independent of the company, a legal relationship could not exist between them, and so there were no "supplies" between them for VAT purposes (*C-210/04*).

The ECJ emphasised various characteristics of the FCE Bank structure, including the fact that the branch did not bear the economic risks of the business. If different facts had applied, it is possible that the ECJ could have reached a different conclusion.

This was tested in *Skandia*, where the company had a foreign branch that was also a member of a VAT group.

Overseas branch and VAT group

Skandia involved a global buying company, established in the US, buying services from external suppliers and supplying those externally bought services to its branch in Sweden. The Swedish branch was a member of a Swedish VAT group. As with *FCE Bank*, the Swedish branch in *Skandia* did not bear the economic risks of the business.

The ECJ's view was that, following *FCE Bank*, the Swedish branch was not independent of the company and so could not be characterised as a taxable person in its own right. However, the ECJ considered that the VAT group was a different taxable person. Consequently, although a company and its branches remain the same legal person, where any one of them is in a VAT group, it is transformed into a separate taxable person. As a result, they may transact with each other for VAT purposes and VAT may become payable in respect of supplies made between them.

The decision was a surprise because, previously, shared functions passing between a company and its branches or between branches, as well as payments and recharges between them, were generally regarded as falling outside the scope of VAT, even where a branch was in a VAT group. The question now is the extent to which this has changed.

Immediate fallout

In Sweden, where a company is trading in Sweden through a branch, VAT grouping only applies to the Swedish branch and not to the company as a whole. As *Skandia* concerned only the Swedish VAT grouping rules, it is arguable that it does not apply to those EU member states, such as the UK, where VAT groups include not only the local branch, but the company as a whole.

This is an attractive argument because it would preserve the status quo in member states not operating along the Swedish lines. However, there is little in the ruling, apart from one ambiguous paragraph, to support this narrow reading. In fact, the Dutch tax authority's initial response was to apply a broad interpretation to the ruling, although this remains under consideration.

Most other tax authorities are taking their time to work out the full impact of the ruling. In the UK, HM Revenue & Customs has indicated that it is continuing to consider carefully what impact, if any, *Skandia* has on the UK rules and whether any legislative changes are required.

Practical implications

Skandia will be of most concern to partially exempt businesses, such as those in the finance and insurance sectors, where a VAT charge arising on an inter-branch transaction often results in an absolute cost, unlike most other business sectors, where the VAT would be recoverable. However, it will also be an important compliance consideration for other businesses.

The implications of *Skandia* are not restricted to countries that operate VAT grouping rules.

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For example, France does not have VAT grouping, and while it may be business as usual for a French branch receiving services from its US headquarters, the position may be different where the services are from a branch in a different member state, that is in a VAT group.

Much of the focus has been on the potential cost that could arise if VAT was chargeable on inter-branch transactions, but that is only one side of the equation.

It follows from *Skandia* that if a branch in a VAT group is capable of receiving services from its headquarters company outside the EU, the VAT-grouped branch can also supply services to the company outside the EU. Where the VAT group is in the finance or insurance sector, this may result in greater VAT recovery for the VAT group. This potential positive result for taxpayers will not have gone unnoticed by tax authorities that are still considering whether to apply the broad interpretation of the ruling.

Before *Skandia*, an international corporate group may have considered establishing a global buying company outside the EU to buy services to supply to a branch in a member state that, in turn, further supplies those services to companies within the same VAT group. If no VAT is payable on the supply from the company to the branch, then no VAT would be payable on the sale of the services at all because all of the supplies within the VAT group would be disregarded. This arrangement was not effective in the UK even before *Skandia* because of the anti-avoidance rules in section 43(2A) of the Value Added Tax Act 1994.

Following *Skandia*, an international corporate group that normally achieves little VAT recovery may consider exploring reversing the arrangements outlined above with the view to increasing its recovery rate, especially if member states are inconsistent in their approach to *Skandia*.

Potential challenges

Tax authorities are not the only persons whose views may have an impact on how this issue develops.

In 2009, foreshadowing *Skandia*, the European Commission (the Commission) considered that VAT grouping should apply only to the local branch, and not to the company as a whole. It noted that *FCE Bank* made no reference to VAT groups and took the view that when a taxable person joined a VAT group, it became part of a new taxable person for VAT purposes, distinct from its fixed establishment located abroad. On this basis, the Commission concluded that excluding the foreign fixed establishment from a VAT group was not at odds with *FCE Bank*.

So, the Commission may object if a member state were to apply a narrow reading of *Skandia* and bring infraction proceedings. The question also arises as to what would happen if a member state now decided to introduce a VAT grouping regime.

A member state would first need to consult the VAT Committee (the Committee) (*Article 11, Council Directive 2006/112/EC*) (VAT Directive). The Committee, which comprises representatives from member states and the Commission, aims to promote uniform application of the VAT Directive across the EU. In light of the Commission's position on the issue, it is difficult to envisage the Committee giving its blessing to any new regime that is inconsistent with the wider reading of *Skandia*.

A taxpayer may also challenge a tax authority if it considers the wider or, as it might argue, proper reading of the ruling would be more beneficial to it.

Looking ahead

Even if it were accepted that a company could transact with itself for VAT purposes where one part of it is in a VAT group, that does not answer all of the questions.

In *Skandia*, the services concerned were bought from external suppliers. Would the position be the same for services generated within the company and shared with the branch? It is interesting to note that, while the question referred to the ECJ in *Skandia* expressly covers externally bought services, the ECJ recast the question simply to cover supplies of services, suggesting that the ECJ did not wish to restrict its decision.

Having said that, a supply of services only arises where there is consideration. Although the question of whether there is a supply depends on whether there is more than one taxable person, whether there is any consideration depends on whether a legal relationship exists that could give rise to consideration.

Because a company cannot contract with itself as a legal matter, a legal relationship cannot exist between a company and its branch (as confirmed in *FCE Bank*). This means that even where, following *Skandia*, the company and its branch are different taxable persons, there should still be no supply of services between them for VAT purposes for lack of consideration. The position is, of course, different between the company and another company in the same VAT group as its branch.

It is unlikely that the full impact of *Skandia* will be worked out any time soon, and it remains unclear how far the VAT group fiction will stretch. It is ironic that VAT grouping was introduced in 1977 at least partly to provide a degree of simplification and yet, 37 years later, practitioners, tax authorities, the Commission and the ECJ are still arguing over the nature of that simplification. In the circumstances, it is advisable to revisit existing inter-branch arrangements to minimise the areas of uncertainty and prepare for future developments.

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